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INTERNATIONAL BUSINESS AND THE EUROPEAN INTEGRATION PROCESS:
THE EXAMPLE OF OUTWARD PROCESSING TRAFFIC
BETWEEN THE EUROPEAN UNION AND
THE CENTRAL AND EASTERN EUROPEAN COUNTRIES

by
Julie Pellegrin

Thesis submitted for the assessment with a view
to obtaining the Degree of Doctor of the EUI
Florence, July 1997

Examining Jury:
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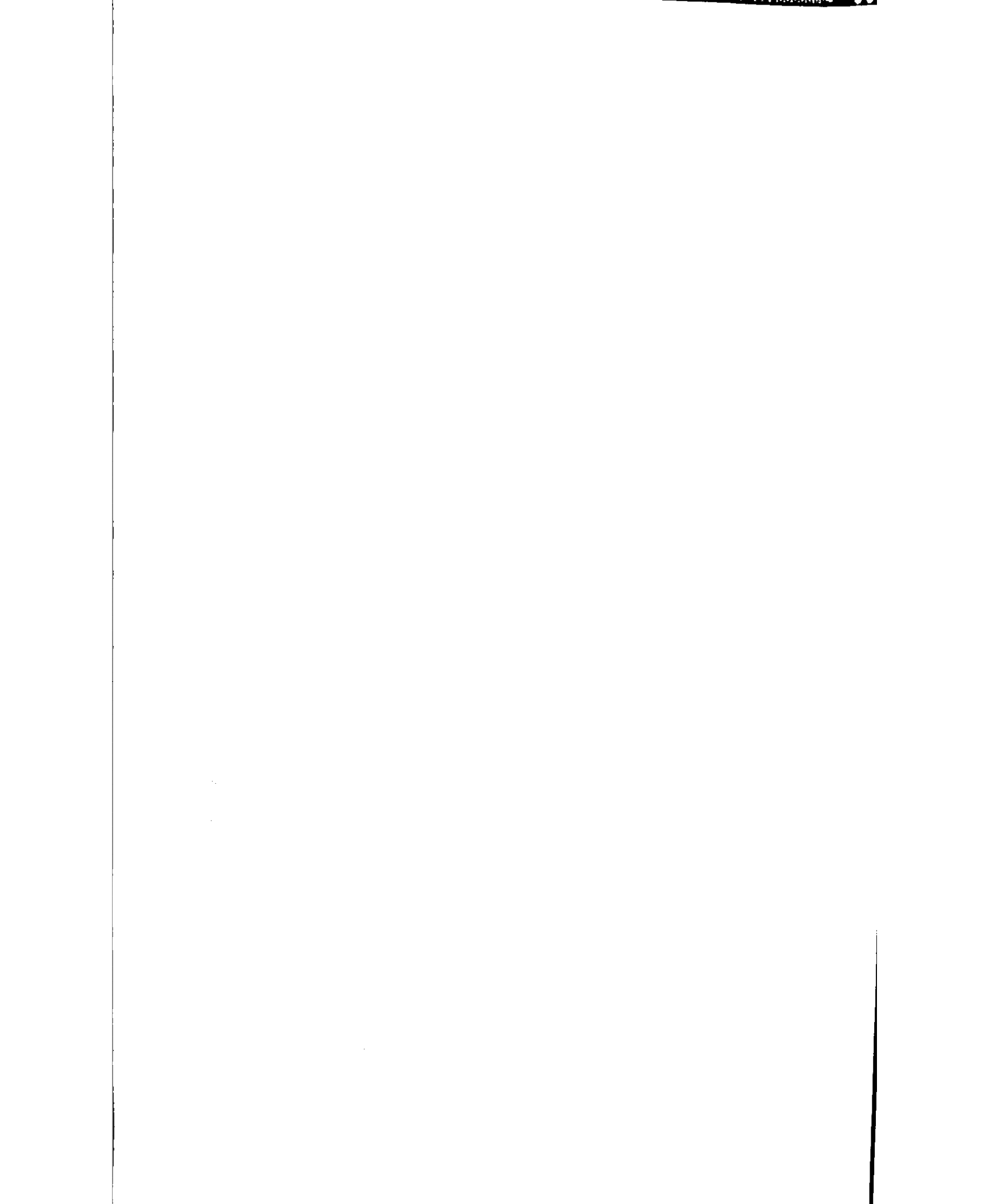
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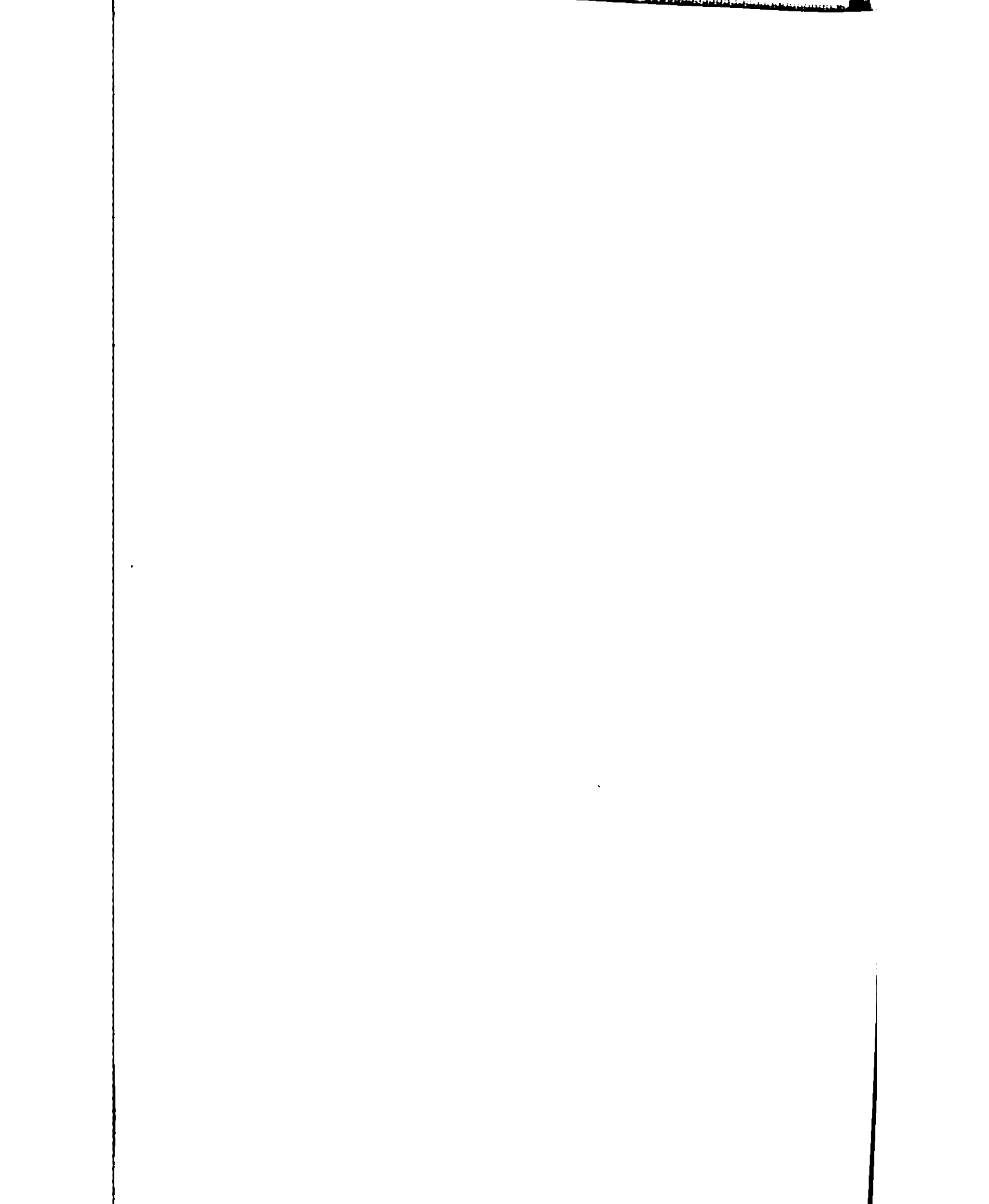


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Introduction

The object of the study and the argument

This dissertation is about the politics and economics of Outward Processing Traffic (OPT). The essence of this trade arrangement is that it helps firms from the European Union (EU) to shift their production of certain manufactures to third countries. If EU producers send material for processing abroad, preferential trade rules designed for the purpose allow the processed products to re-enter the Single European Market without being subject to trade protection measures pertaining to 'normal' one-way trade. OPT thus promotes the relocation activities of EU firms to low wage countries while discriminating against the exports of local firms from these very countries; the latter benefit from a preferential access to the EU only in co-operation with EU firms, otherwise they face 'normal' protection.

The analysis is geographically restricted to the outward processing activities of EU firms in Central and Eastern European countries (CEECs)¹ as these are the object of additional specific preferential treatment.

This subject might seem quite narrow and specialised. But in fact, it throws very significant light on two matters at the centre of current theoretical and policy debate: 'globalisation' and 'governance'. The focus on OPT exemplifies the attempt to establish a system of governance of the wider European market economy in response to the imperative of globalisation. The dissertation shows that the actual working of this system calls into question the adequacy of a conception of governance of the economy underlying the European integration process.

¹ The expression was used by the Community to refer to the European COMECON countries. It is still utilised but with no clear-cut definitions. Roughly, 'Central Europe' includes Poland, Hungary and the former Czechoslovakia, whereas Eastern Europe could cover Romania and Bulgaria. See Maresceau (1992: 94). The dissertation is mainly concerned with the cases of the former, commonly considered to be 'front-runner' in the process of accession to the EU.

Importance of the subject

Rationale and limitation of the OPT policy

Globalisation -the multiplication of opportunities in a increasingly open and liberalised world market economy- brings many new and challenging issues to the agenda of policy-makers [Stopford, Strange: 1991]. The OPT arrangement is an instrument in the hands of Community policy-makers with outstanding potentials to simultaneously address many of them.

First, it promotes the relocation strategies of home firms while keeping the process under close political monitoring. By ensuring that the levels of domestic employment are not adversely affected, it thus reconciles the conflicting objectives of international competitiveness and domestic employment.

Second, it makes sure that trade liberalisation does not harm vital domestic interests. It forces foreign firms into co-operation with EU partners where the former present a competitive threat and ties them into vertical production chains controlled by EU firms. It thereby achieves the transformation of 'rival' patterns of trade and production into 'complementary' ones [Zysman, 1996]. By granting specific incentives to undertake OPT in CEECs, it influences the terms of economic interdependence between Western and Eastern Europe and promotes the vertical division of labour throughout the region.

Thus, it makes possible the formation of a 'unified European economy' under the influence of decisions and objectives adopted, through negotiations at the Community level, in response to the challenges posed by 'globalisation'.

In fact, the actual contribution of OPT to the patterns of economic interdependence between the EU and CEECs reveals that such potentials are seized by firms only in certain countries, only in certain sectors and without necessarily strengthening the centralisation of competence at the Community level.

In general, OPT played an important quantitative role in the reorientation of CEECs trade to the EU.

In some specific sectors (mostly Textile and Clothing), OPT effectively spurs a durable vertical rationalisation of business strategies at the regional scale which reconciles the conflicting objectives of employment and competitiveness. But when this is the case, it is not so much due to measures taken at the EU level, than to incentives granted by individual governments to domestic firms.

In the other sectors concerned by OPT, the arrangement does not serve the above policy objectives. It is almost exclusively German firms who take advantage of the arrangement in order to carry out 'workbench' activities in low labour cost neighbour countries (mainly the Czech

Republic). Proximity and industrial legacy matter more in the choice of corporate strategies than policy guidelines designed by the Commission.

Thus the logic underpinning the adoption of the OPT measure is flawed in at least two ways. First, even if a compromise is reached at the EU level, it does not really harmonise the diverging interests in presence in the OPT debate. Second, the contribution of OPT to the dynamics of regional integration is highly uneven, and the expected complementarity between Eastern and Western patterns of specialisation rather unpredictable.

Overall, OPT illustrates how the terms of East-West economic interdependence owe more to corporate strategies decided within different national frameworks of constraint and opportunity than to a coherent policy devised at the Community level.

1.

The wider significance of OPT

The OPT arrangement is devised according to a traditional conception of the Governance of the economy which applies to the process of European integration. But the actual developments of the arrangement testify to alternative mechanisms at work in the management of the wider European market economy.

The OPT arrangement illustrates a conception of Governance which is strongly rooted in a traditional view of the proper exercise of political authority over economic matters. Its mechanisms rest on the assumption of the congruence, over a bounded territory, between political competence and the structuration of economic activity: OPT patterns are to be shaped within an enlarged Europe under the influence of decisions taken by the Commission which centralises and mediates various social and political interests. Hence, OPT corresponds to an attempt to transpose the national model of market management at the Community level; the difference is merely one of scale, not of nature.

However, the OPT empirical evidence provides an alternative picture of where and how economic activity is effectively politicised.

The OPT example testifies to a large number of actors of distinct nature but of comparable weight taking part in the policy-making process which different modes of interaction within the Community institutions yield quite contrasted patterns of structuration of economic activity.

First, national governments with different positions and different political clout in the Community negotiations on OPT retain a decisive influence on the corporate strategies of domestic firms. Second, firms themselves prove to be players of primary importance in the game. Indeed, one of the main analytical contribution of the OPT analysis is to bring them at the centre of the stage in the study on International Political Economy. For a start, the OPT policy was

adopted to answer firms' political demand. Moreover, it is firms' strategies which give their full significance to the political and institutional determinants of OPT. And in the last resort, it is firms which are among the main beneficiaries of the OPT policy devised at the EU level.

Consequently, the patterns of OPT which develop as a result of the bargain, on the Community arena, between these actors, are extremely idiosyncratic involving privileged partner countries in specific sectors. They follow different 'trajectories' which contribution to the dynamics of regional integration, far from being univocal, depends on the countries and the sectors concerned.

We are thus far from a system of market management where the economic outcome is structured in harmony with social and political objectives decided in a constituency territorially defined. Indeed, this traditional view is obsolete in the context of growing economic interdependence. First, the reference to a territorial unit of analysis is at odds with the patterns of interconnectedness shaping the world economy. More fundamentally, the pre-eminent role played by firms in the OPT story questions the implicit assumption that political control over the economic outcome is exercised solely by a centralised authority. It testifies, in fact, to the 'diffusion' of the exercise of power: a shift of prerogatives to the benefit of market actors, at the expense of traditional centralised political authorities [Strange, 1996].

The conceptual implications for the process of European integration are far-reaching. OPT illustrates how the European Integration process owes part of its *raison d'être* to the establishment of a system of Governance in response to the challenge of globalisation. But if 'Europeanisation' is to provide a credible response to globalisation, then not much should be expected from a transposition of the national model at the Community level. Rather than justifying European integration on the grounds of the unification of an hypothetical regional European economy under the aegis of a centralised political authority, the OPT story insists that firms, alongside governments, are exercising authority over the economic outcome.

Evidence

To achieve the assessment of the political and economic consequences of the OPT policy, the dissertation used three sources of evidence: statistical data largely neglected by the academic community², interviews with civil servants in charge of the OPT legislation-making at the Commission of the European Communities in Brussels, and fieldwork with local partners in two host countries (the Czech Republic and Hungary).

Evidence on the policy-making process

Centralisation of competence at the EU level in OPT matters is unachieved. In the Textile and Clothing sector (T&C), national authorities have managed to preserve part of their traditional prerogatives in the fixation of quotas. This rendered the definition at the Community level of the terms of the preferential OPT treatment granted to EU producers particularly difficult. The other sectors are subject to the Common External Tariff. Centralisation of competence is therefore in principle already achieved, and the legislation-making process has not given rise to the same degree of controversy as in T&C.

As a result, the benefits of the arrangement have been, and still are, unevenly distributed among EU firms, depending on the sector and the country to which they belong. For example, German firms could benefit from a very liberal application of the Community legislation by German authorities.

Evidence from statistical data

Three important features characterise OPT relations between the EU and CEECs:

- the quantitative importance of OPT in proportion of the total exports of CEECs to the EU,
- the dominant share of German operators in the total OPT activities of EU firms in CEECs,
- the prominent role of T&C in the product structure of OPT relations between the EU and CEECs.

A fourth important characteristic is the very contrasted evolution ('trajectories') followed by 'OPT networks'. In T&C they are homogenous as OPT shares increase continuously; in the other

² Even though they are in principle made easily accessible by EUROSTAT, in particular through the use of CD-Roms (COMEXT database).

sectors, the trajectories of OPT networks are marked by strong country-variations. For example, German OPT activities tend to decrease in Hungary while they are very diversified and dynamic in the former Czechoslovakia.

Evidence from fieldwork

The actual evolution and the prospect of OPT partnerships vary widely from firm to firm. In certain cases, local partners are able to take over the OPT production on their own while EU firms switch to other locations; in other circumstances, EU partners transform OPT co-operation into a relatively steady and possibly up-graded partnership. More seldom, but still possible, local firms are forced to close down following the sudden withdrawal of their partners.

Much depends on whether EU firms actually take advantage of the potentials for control over the two extremes of local partners' production chain. Paradoxically, it might prove safer for local firms to further their dependence on one EU partner and thus secure a steadier partnership. This is more likely to happen in the case of big firms, and in the T&C sector.

Theoretical backgrounds

The high heuristic value of OPT makes it possible to assess the European integration process in the light of the challenge that the globalisation of economic activity poses to political governance. This is in the last resort the ultimate relevance of an analysis of OPT; but the latter is actually made of several so to speak 'sub-contributions' which are no less interesting, even when taken separately.

Such different contributions made by an analysis of OPT draw on several theoretical backgrounds which, in turn, benefit from their confrontation with the OPT empirical case. One first theoretical body relevant to the OPT development concerns theories on European Integration. Besides testing the contribution of theoretical developments on interest representation and policy-making at the EU level, the OPT case is relevant to the debate on the reason why EU governments have found it necessary to resort to the European level of action. It dismisses at the same times the neo-federalist view of an United States of Europe, the neo-functional focus on co-operation as a necessary 2nd-best, and the neo-realist assumption of the continuity characterising the diplomatic game. What the evidence provided by the OPT case suggests is that 'Europeanisation' is a response to the internationalisation of firms' strategies adopted by national governments in order to recapture political control over growing economic interdependence (Chapter 5).

The OPT example is also useful to test various conventional theories in neo-liberal Economics, notably those based on the notion of comparative advantage (Samuelson, Bhagwati, Porter ...) which tend to presume these advantages are given. The OPT analysis identifies the very process of trade liberalisation, *its pace and its form*, as an important determinant of trade and production specialisation patterns. This has been seriously underrated in International Trade theories (Chapter 4).

At a more disaggregated level, the OPT data illustrate how Community firms actually take advantage of market and institutional opportunities to reorganise their international production activities across Europe. This is of direct relevance for the studies of International Business and International Production. In this respect, an important insight gained by the OPT analysis is that trade restrictions are a useful substitute for internalisation under certain conditions. They make possible the 'quasi-vertical integration' of firms party to an OPT agreement which enables foreign firms to control local partners *without undertaking capital engagement* (Chapter 4). A direct implication is that statistics on Foreign Direct Investment hide more than they reveal in the study of Political Economy.

Finally, an analysis of the various trajectories OPT partnerships are likely to follow sheds some light on the terms of the dynamics of regional integration and makes an interesting contribution to theories of Economic Development (Chapter 5).

Overall, the analysis of OPT provides a useful framework of analysis weighting and ordering market determinants, institutional factors, and firm-level variables impinging on economic activity.

Methodology and structure of the dissertation

The methodological discovery providing important evidence for the argument was that OPT trade data allows us to distinguish between 'normal' and temporary trade. Three features characterising these data motivated the choice of OPT as a Dissertation topic:

- the quantitative importance of OPT in proportion of CEECs' total trade,
- the fact that OPT data offer a statistical trace of the relocation activities of Community firms
- the fact that OPT offers empirical material on the interaction between business strategies and the legal framework providing for the regulation of economic activity.

On this basis, a systematic enquiry was undertaken asking all over the same question: what is at stake in the trends and experiences observed?

The organisation of the chapters is determined by the strong empirical grounding of the present study. The available evidence on OPT is first presented. The potentially relevant theories are then confronted with the reality of OPT, showing how far it is necessary either to modify them or to reject them.

The first part offers a comprehensive description of the framework of constraints and opportunities within which Community firms design their strategies of OPT relocation to CEECs. Chapter 1 looks at the OPT legislation and the objective it follows; it accounts for the complex legislation-making process that yielded it. Chapter 2 is concerned with the market forces inciting firms to undertake OPT in CEECs. It makes clear how the latter (wage differentials) are actually significantly altered by the very process of trade liberalisation to which the OPT measures contribute.

The second part of the dissertation aims at a systematic analysis of the patterns of OPT relations between the EU and the CEECs resulting from the above framework of constraint and opportunity. The empirical investigation of OPT contained in Chapter 3 is based on statistical data and fieldwork. It makes possible the identification of different OPT networks characterised by widely diverging trajectories and different impacts on the terms under which economic interdependence is currently taking place between the EU and CEECs. Chapter 4 accounts for such a feature. With the help of two bodies of literature, International Trade and International Production theories, it tries to make sense of the potential OPT determinants proposed in Part I.

The final part elaborates the general implication of the development of OPT between the EU and CEECs. It shows how particularly relevant the OPT case is for the understanding of the rationale and the mechanisms underlying the European integration process in both its deepening and widening dimensions (Chapter 5). In the last Chapter, the ultimate relevance of the OPT story is fully drawn: the Chapter pieces together the different findings of the dissertation and shows that they all make sense with respect to the central issue of the governance of the economy in the context of ever growing world-wide economic interdependence.

I/ The framework of opportunity and constraint

The Outward Processing activities of EU firms in Central and Eastern European countries is an extreme illustration of the politicisation of economic transactions. This is so first because the arrangement takes place between two geographical area which are traditionally prone to the political management of their economic relations, and, second, because it applies the mechanisms of protectionism, intended in its most traditional and 'dirigiste' sense.

In a first approach, the dissertation explores the framework of opportunities and constraints shaped by market, political and institutional determinants within which firms take their strategic decisions. Three series of such determinants are relevant in the case of Outward Processing Traffic; interestingly enough, only one of them is directly ascribable to market forces:

- in the specific case of Central Europe, OPT takes place within the context of economic transactions which have been and still are largely dependent on the course of the 'high politics' governing the relations between Central Europe and the EU

- market determinants, especially wage differentials as the opening up of CEECs economies made readily available an abundant, cheap and relatively skilled labour force

- the action of governments aiming at fostering the international competitiveness of their firms

If the factors determining the quantitative and qualitative features of OPT relations between the EU and CEECs are easily identified, it is nevertheless important to refrain from inferring too simple a determinism. In fact, a dynamic approach allows to understand how intricate the causation can be. Sure, firms deploying their production activities Eastwards aim at taking advantage of market opportunities within the constraints fixed by the institutional setting enforced. But they also contribute in shaping the environment within which they take their strategic decisions. In other terms, firms and governments, the actors party to the game, interact so as to influence the development of OPT relations between the EU and CEECs.

The present part aims at identifying and ordering the various determinants of OPT relations between CEECs and the EU. If anything, it shows the pre-eminent role played by national governments mediating between the formation of EU firms' corporate strategies and the 'framework of opportunity and constraint' provided by the Community arrangements, and market forces. Registering firms' political demand and deciding on policy priorities and objectives, state authorities are at the centre of the feed-back process between institutional and market determinants on the one hand, and corporate strategies on the other hand.

This first part paves the way for the subsequent analysis of the very content of OPT relations and of their wider implications for the development of the pattern of interdependence between Eastern and Western Europe.

Chapter 1. Global challenge: the trade-off between domestic employment and international competitiveness

"Outward Processing Traffic" would not exist if there were no trade barriers. Indeed, OPT transactions owe their very *raison d'être* to the specific custom regime easing trade restrictions faced by EU firms relocating part of their activities abroad. OPT is therefore not an independent phenomenon merely constrained by legislative provisions and captured by an allegedly neutral statistical instrument.³ On the contrary, OPT is the very product of the legislation providing for it.

Thus, one primary set of constraint and opportunity influencing the formation and the development of EU firms' OPT strategies in CEECs is the legislative framework (the 'straightjacket' would, in certain cases, be more appropriate) providing for its basic principles. If anything, this peculiar feature characterising OPT illustrates how decisive institutional settings in general, and legislative frameworks in particular, can be in the formation of economic transactions.

Before assessing what type of incentives the OPT legislation represents, the present Chapter seeks to determine the very source of such constraint and opportunity, and tries to understand the logic governing its adoption. Looking at the decision-making process that yielded the OPT legislative arrangement shows that the origin of the legislation has to do with a policy dilemma posed by the internationalisation of production activity. Firms willing to relocate the totality, or part of their production process abroad on the grounds of exceedingly high domestic labour costs might be dissuaded to do so by the presence of trade barriers. As a matter of fact, 'reimporting' products which have been processed abroad might come against trade measures enforced to protect against *any* exports from low labour costs countries. The solution proposed by the OPT arrangement is to discriminate between the imports of local producers and the 're-imports' resulting from the relocation strategies of Community producers.

The Chapter shows that enshrining such an apparent anodyne mechanism into law has actually given rise to a complex bargaining process. The debate revolves around the old opposition between the advocates of protection and those favourable to free trade. It has involved numerous actors, and has taken place on various arena: within domestic constituencies, between firms, federations of industry, and labour unions, and at the European level, between virtually the same actors plus confederations of Industries and of Labour, member states and the institutions of the Community participating to legislation-making at the EU level (the Commission). In the

³ As a matter of fact, without such an arrangement, there would be no statistical possibility to distinguish between 'temporary' and 'normal' trade flows.

following, an attempt is made to 'map' the interests in presence in the OPT debate, and to understand how they translated in the legislation providing for the arrangement at the Community level.

1. 1 Trade policy and the challenge of international competition

A major characteristic of "OPT", its ambivalence, makes possible the conciliation of different policy objectives which are in principle contradictory. On the one hand, OPT can be considered to be a useful instrument for preserving employment at home; on the other hand, the arrangement can be viewed as a window of opportunity for relocating production activities in otherwise highly protected sectors. It is therefore no surprise that there are numerous and conflicting interpretations on how to use such an instrument of trade policy. Indeed, interests in presence are aligned according to many sectoral and national cutting lines; the present section identifies them.

1. The OPT raison d'être: protection vs relocation

The adoption of OPT as an instrument of trade policy was born in the context of the competitive pressure placed on declining industries of developed economies by exports from low wage countries. An immediate policy response to such a threat is protectionism. There has been indeed different historical waves, to be distinguished according to the nature of the protectionist measure adopted: tariffs and Non-Tariff Barriers (first among which quantitative restrictions like quotas), but also more recent and innovative devices such as anti-dumping and countervailing duties ... ("neo-protectionism"). But in the long-term, the recourse to a pure and 'classic' protectionist strategy might prove unsustainable in the face of the fast-growing interdependence in the world-economy. For example, one serious drawback of such protectionist measures is that, while protecting declining sectors as a whole, they also prevent the most dynamic home-based firms from taking advantage of opportunities on a global scale. Indeed, protectionism might imperil the complete or partial relocation of production activity to low wage countries which is an alternative way for weathering the competitive pressure pertaining to exports from these very same countries. When it concerns only certain stages of the production process, relocation is associated with a double flow of trade: exports of material to be transformed abroad, and re-imports of the processed goods in the country of origin. If these latter are subject to the same

protectionist measures as normal imports, then firms might be dissuaded from undertaking relocation strategies.

This dilemma was resolved by the ingenious device of OPT: to discriminate between "direct" and "temporary" trade flows on the basis of the motive of the transaction (further processing or direct sale), and the content of the products concerned (do "imports" contain locally-sourced components, or / and material previously exported from the country of destination?). If a product exported by a Community firm in order to be processed abroad faces 'normal' trade restrictions when it is re-imported into the Community, then OPT makes it possible to lift such measures of trade protection, either partially, or even, in certain cases, completely.

Institutionalising a specific custom regime is the most straightforward way to implement and monitor the distinction between permanent and temporary trade flows. Historically, it is the United States who first "invented" and used such an arrangement.⁴ On the European rim of the Atlantic, a version of the arrangement was adopted in 1975, and under a substantially altered form (see below).

Interestingly enough, the ambivalence of the arrangement as regard the trade-off employment / competitiveness is made explicit in the European legislation providing for the arrangement. Indeed, the Preambles of the various texts providing for OPT at the Community level state that the objective is to allow for the adjustment of the EU T&C industry to "the conditions of international competition".⁵ But another priority, that of preserving production within the Community appears to be in clear contrast. In this respect, the Preamble of one of the first versions insists that the arrangement be reserved to producers with plants located *within* the Community whereas another version adds to the obligation of maintaining production in the Community that of preserving the level of employment. Thus, potential conflicting *raison d'être*s pertaining to the arrangement are already contained in the Preambles of the texts providing for economic OPT.

⁴ These provisions were enforced in the 30s in the then US Tariff Schedule, Items 806.30 assesses a duty on the foreign value added of US metal products, whereas 807.00 grants duty-free entry to other US material and components. They are now HTS US 9802.00.600, and 902.00.800.

⁵ Rather euphemistically, the 1975 Preamble states that OPT would allow Community firms to take advantage of 'appropriate technical facilities, or the exclusive use of a patent' in possession of foreign firms. Needless to say that it is low wages that are of interest here. See Footnote 7.

2. The OPT main features: sectoral and national variations

An important feature characterising what became in the Community jargon "OPT" is that there are actually *two* OPT regimes. Indeed, to each of the two traditional protection measures, tariffs and quantitative restrictions, corresponds a specific OPT arrangement. When trade barriers consist of quantitative restrictions, the OPT beneficial treatment grants additional specific quotas. By contrast, when tariffs are enforced, European OPT, as in the American case, consists of a partial or a total suspension of duties.⁶ Hence the distinction between '*Economic OPT*' (applying to goods subject to quantitative restrictions) and '*Tariff OPT*' (regulating the conditions under which tariff relief is authorised).

Interestingly enough, the distinction between 'tariff' and 'economic' OPT depends both on the nature of the adopted protective measure, and the sector where the latter is enforced. This feature allows the broad distinction between Textile and Clothing (T&C), protected mostly by quantitative restrictions, and almost all the other sectors subject to tariff protection. Hence sectoral variables are a first important criteria distinguishing among the two OPT regimes.

But there is another very important dividing line: the authority which is ultimately responsible for the provision of the specific OPT preferential treatment. In principle, since trade matters are the competence of the Community, OPT is subject to EU legislation. The first Community regulations dealing with OPT developed as of the mid-70s with the very first comprehensive text adopted at the end of 1975.⁷ It is worth stressing that it is a *directive*, i.e., that it has to be translated into national legislation before acquiring their bindingness.

In practice, however, the prerogatives of the Community were effective only in the tariff regime. Indeed, being the provision of quantitative restrictions one of the few trade-related domains where national authorities preserved their prerogatives⁸, the management of the economic regime tended to escape the control of the Community. In fact, member states enjoyed considerable room for manoeuvre while deciding whether and under what conditions to grant OPT specific *national* quotas. This explains why economic OPT regimes were characterised by sometimes strongly different *national* variations. Hence, beside the criteria of the nature of the trade restrictions pertaining to the concerned good, the distinction between 'economic' and 'tariff' OPT corresponds to two additional (overlapping) dividing lines:

-the sector (most products in T&C are candidates for economic OPT, whereas the other sectors are eligible for tariff OPT)

⁶Most commonly, the incoming tariff is calculated on the basis of the value added during the processing abroad. But there are other possible formula.

⁷ Council Directive of 18 December 1975, in OJ L 24, 30.1.76.

⁸ At least until 1993.

-the authority in charge of the *actual* provision and application of the OPT legislation (national authorities in the case of economic OPT, and the Community in the case of tariff OPT).

Thus, the distinction between the tariff and the economic OPT regimes depends both on the sectors to which they respectively apply, and differences *within* the economic OPT regime depend on the country under scrutiny.

3. Guiding principles at the Community level (sectoral variations)

The existence of two distinct protective measures (tariffs and quotas) and their associated OPT regimes, is reflected in the Community law. At the origin, however, the 1975 text applied to both cases and provided the basic principles of OPT without much refined details as to the nature of the protection measure the arrangement was supposed to lift. The benefit of the arrangement was meant to consist of the partial or total suspension of tariffs⁹; eligible products could be of whatever kind of origin¹⁰; and the type of processing activities they were authorised to undergo abroad was only loosely binding¹¹. As to the beneficiaries, they just had to be a natural or a legal person established within the Community.¹² Re-imports after processing could be done in any member state¹³, and a transfer of ownership during the transaction was possible¹⁴.

On this basis, the legislation on "Tariff OPT" was adopted without much debate, and no substantial changes altered the above rules.¹⁵ Its 'technical' objective was to distinguish between a "pure" form of OPT, and temporary exports and reimports in the view of *repairing* products (the so-called "standard exchange system"). This second text defined more precisely the eligible products as goods which are either of Community origin, or in free circulation¹⁶, it also referred to beneficiaries as being established in the Community, *and* offering enough 'guarantee' to the

⁹ Op. cit. Art 10 distinguishes different cases according to the nature of the incoming tariff.

¹⁰ Op. cit. Art 2.

¹¹ Namely: the 'working of goods', the 'processing of goods', or the 'repair of goods', with no more details. See op. cit. Art 3.

¹² Op. cit. Art 4, 1.

¹³ Op. cit. Art 7.

¹⁴ Op. cit. Art 9, 1.

¹⁵ Council Regulation of 24 July 1986, OJ L 212, 2.8.86.

¹⁶ Op. cit. Art 1, 3, b. Goods that are under the "free circulation" regime were imported into the Custom territory of the Community and discharged from the incoming import tariff.

relevant custom authorities.¹⁷ It is worth noting that no mention was made as to whether it was possible to re-import the processed products in a different member-state than that which issued the OPT authorisation. This feature contributed in making the arrangement particularly open and flexible.

The legislation on Economic OPT is much more complex and technical than its counterpart in the Tariff regime. Indeed, the 'Economic OPT' regime in Textile and Clothing gave rise to a much more tortuous process of legislation-making. The reason has to do with the contention of prerogatives between the national and the supranational levels in the field of quantitative restrictions which make the definition of clear guidelines particularly difficult to achieve. Two texts were adopted, the 1st in 1982¹⁸ and the second in 1994¹⁹ in an attempt to "harmonise" the different national OPT regimes. One consequence is that recourse to the Economic arrangement is much more tightly regulated, with a clear resulting restrictive bias. For example, an attempt is made to define the level of authorised processing abroad more 'precisely'²⁰, as well as quantitative restrictions set at national levels²¹; also, it is made clear that re-imports after processing must be geared back to the country of origin²².

Before going into more details of the points of contention at stake in the Economic regime as provided for at the Community level, it is useful to identify the different positions of the member states on the matter.

4. National variations

The following description of the national OPT regulations shows how different policy standpoints have been adopted throughout member states when applying the Community guidelines concerning OPT in the T&C sector. Not only were the national positions on OPT widely contrasting from country to country, but they also evolved sometimes dramatically in quite unexpected directions. It is possible to trace these policy-orientations through the

¹⁷ Op. cit. Art 5, 1, a.

¹⁸ Council Regulation 636/82, 16 March 1982, OJ L 76, 20.3.82.

¹⁹ Council Regulation, 3036/94, 8 Decen.ber 1994, OJ L 322.

²⁰ Council Regulation 636/82, 16 March 1982, Art 2, 2, (d). Namely, "processing from woven or knitted fabrics".

²¹ Op. cit. Art 2, 2, (b), and Art 3, parag 1. It is interesting to note that introducing specific OPT quotas should not entail the overall increase of the quantities allowed to penetrate the EU markets. It implies, therefore, that "direct" quotas be reduced proportionately. See op. cit. Art 2, 3, parag. 3.

²² Op. cit. Art 8, 2.

respective national regimes providing for OPT prior to the harmonisation procedure undertaken by the Community in the 80s, and then through the application of the Community Regulations at the national level.

1st cutting line: the provision of an OPT regime

An important divide takes place between those member states which established liberal OPT regime, and those which were rather reluctant to enshrine specific measures, if at all adopting only very restrictive provisions. The first country to adopt specific OPT quotas was Germany.²³ Two other countries followed: the Netherlands and France²⁴. At the other extreme, the last country to provide for specific OPT quota was the United Kingdom. Indeed, until 1986, not a single OPT quota has been released by the British authorities. What is more, the British representatives in Brussels systematically voted against any establishment and increase of quantitative restrictions at the European level.²⁵

2nd cutting line: liberal vs restrictive applications

Whether a specific OPT regime is provided for is one thing; whether a granted regime is more or less liberal is a second important feature differentiating member states. It is no surprise that the first countries to adopt specific measures dealing with relocation were also those which adopted the less stringent sets of rules. The German and the Dutch legislations were so loosely designed that they were almost not binding. One very important feature characterising them was their openness to all the companies, irrespective of their actual economic status, be they established producers, or retailers like C&A without production facilities. On the contrary, Belgium and Italy set up OPT legislations, but attached quite stringent conditions of access to benefit from the arrangement. Not only had beneficiaries to be producers located within the Community, but they also had to respect various thresholds of production levels maintained in the Community. In addition, a series of provisions were explicitly designed to contain the intrinsic bias towards job-exports proper to the arrangement. In Belgium, for example, there is a long-standing policy concern dealing with the detrimental impact of relocation on the level of

²³Two different types of OPT were originally devised: 'normal' OPT, which figures were regularly published, and 'co-operation' OPT. This peculiar definition poses problems of comparison.

²⁴French OPT business was very active in Northern Africa. But there were no quota, thus no figures. As a rule of thumbs, because of national disparities in OPT statistics, and because the Commission did not centralise OPT-related information, there is no way to trace the evolution of OPT back to its origin.

²⁵It is worth stressing that member states' initial positions in the OPT debate do not necessarily match with what common wisdom considers to be the traditional divide opposing free traders and protectionists within the Community. The most conspicuous examples are in this respect the United Kingdom and Ireland: they are both considered to hold relatively liberal views on trade issues, but they both actually opposed substantial pressure against the liberalisation of the OPT arrangement.

employment²⁶ Thus, the authorities imposed that OPT should be reserved to producers relocating less than 30% of their value-added in third countries, with a resulting employment level no lower than 90% of the original position. Unions played an important role played in this respect. Being strongly opposed to the OPT arrangement, they contributed in rendering the positions of the government and that of the industry more difficult to harmonise.

3rd cutting line: the entrance of late-comers in the Community

Dynamic considerations significantly changed the above-described starting positions over time. Initial positions underwent the following significant modifications: on the one hand the United Kingdom, but also albeit belatedly, Italy and Belgium became converted to the benefits of OPT; on the other hand, new comers (especially Portugal, but also Greece and Spain) renewed political forces opposing OPT. The United Kingdom witnessed the most dramatic change of policy objectives. In 1986, under the ruling of M. Thatcher, the official position of the British authorities underwent a sudden U-turn; OPT was subsequently embraced as a relevant restructuring strategy, if anything, not to be hampered by restrictive trade policy measures. The Italian official position also evolved from a fundamentally wary perspective to a more openly positive approach, echoed by the Belgium authorities who progressively relaxed their initially very strong opposition against any preferential regime favouring relocation. It should be stressed that such evolutions never truly led the concerned national authorities to reach positions as liberal as the German ones. For example, each of the three above-mentioned countries remained hostile to the idea of extending the OPT arrangement to retailers.

Finally, the opposite tendency was registered as the result of the accession of new members to the Community. Overall, to the original opposition mainly organised around the British and German poles, the 80s come to be characterised by a North-South divide, with Southern newcomers hostile to OPT, and Northern members more prone to liberalise the OPT regime.

²⁶ The main concern of the government finds another more direct expression in the 'Plan Textile' openly designed to salvage employment in the T&C sector.

1. 2 Policy-making at the Community level

1. Necessary harmonisation

As hinted above, the recourse to the European level in OPT matters is grounded on the fact that trade policy matters are in principle under the exclusive competence of the Community.

It is worth insisting on the actual sequence of the respective adoption of OPT policies at the national and European levels: what is stake in the Community intense legislative activity is actually to *recapture* control in a field where member states had unduly extended their competence. So the first text on economic OPT, adopted in 1982, was essentially intended to monitor the way national authorities were granting specific quantitative restrictions besides normal quotas. At the beginning, when the first countries started to impose specific OPT quotas (Germany followed by the Netherlands and France), the Commission was almost automatically endorsing the authorisation given at the national level.

There were 3 groups of concerned host countries at that time: North Africa (Morocco and Tunisia), Yugoslavia, and the then Centrally Planned Economies, all of them being classified at the lowest degree in the hierarchy of preferences granted to the Community's trade partners.²⁷ However, from 1980 on, the Commission started to slow down the pace of quotas attribution as trade conditions with this latter group of countries looked as if they might become less restrictive than those with other countries supposedly benefiting from a preferential treatment. Legislation at the Community level was thus made necessary in the Commission's view in order to curb what it saw as an excessive degree of autonomy enjoyed by member states. The decision to control OPT quotas at the Community level had logically to be accompanied by an homogeneous definition of the specific conditions of eligibility that distinguish the OPT regime from the regime on direct imports.

The 1982 text, in turn, had to be revised. The endeavour, this time, was connected to the necessity of eliminating any potential degree of autonomy accruing to member states that could prove incompatible with the objective of the Single European Act. As a matter of fact, being seriously imprecise on several key points, the first version left significant room for manoeuvre in its interpretation. Contrarily to the intention, the text was thus applied very differently by member states. With the coming into force of the Single Market in 1993, such divergence of trade conditions in the different member states could no longer be tolerated; indeed with the complete removal of internal trade barriers, the risk is that all OPT activities be concentrated in

²⁷ In the hierarchy of EU trade relations, centrally planned economies came last, after the MFA countries, and countries benefiting from a preferential regime. Under the "autonomous regime" that was supposed to regulate such trade relations, OPT quota were provided for unilaterally. With the conclusion of the Europe Agreements between CEECs and the EU, OPT quotas became subject to bilateral negotiations. To be precise direct quota were not included into bilateral negotiations until 1979, and OPT quotas ... until 1992.

the most liberal member states which would subsequently reexport 'exceedingly' competitive products to other more restrictive countries. The Commission had therefore to endeavour once more to harmonise the different national positions. Once again the legislative exercise consisted in defining guiding principles as precisely as possible in order to avoid possible diverging interpretations. And yet, once more, the exercise was only partially successful. After two years of negotiations, a text was adopted in 1994 which contained several imprecisions.

However, two absolute prerequisites of a technical nature were at least fulfilled. First, quotas on OPT, like all the other quantitative restrictions, were no longer to be broken down into member states' shares, but rather fixed at the Community level.²⁸ Second, re-imports after processing had to be allowed in any member states, regardless of who issued the OPT authorisation.²⁹ Finally, it is worth noting that the text expectedly achieved the formal task rendered necessary by the conclusion of "Europe Agreements" with Central and Eastern European countries.³⁰

It appears that, overall, the whole *raison d'être* of the economic OPT arrangement is very much ascribable to the harmonising endeavour undertaken in the context of the working of the Community institutions. In this view, the initiative of the OPT decision-making process essentially belongs to the Commission, which is moved by the objective of achieving a smooth functioning of the Single Market. However, it is the initial decision taken by individual member states to grant specific OPT quantitative restrictions which actually triggered the whole process.

2. Harmonisation in practice

The above description of the content and the principles regulating the arrangement underplays the outstanding degree of controversy aroused in the legislation-making in the field. It would be, in this context, misleading to assess the Community endeavour on the basis of the final texts achieved. Indeed, too literal an interpretation of the text might lead any beginner to a nervous breakdown. What is of particular interest, instead, is to trace the process that led to the adoption of the texts.

²⁸ Council Regulation, 3036/94, 8 December 1994, OJ L 322. Art 3, 1. See also Council Decision of 20 December 1993, in L123, 17/05/1994 for the actual quotas with CEECs.

²⁹ *Op. cit.*, see the Preamble.

³⁰ See Chapter 2.

To see how the harmonisation endeavour proceeded, and whether it was eventually successful, it is worth tracing for each provisions subject to controversy what were the interests invested, and the channels through which they were represented. Also, when a final agreement was decided, which were the mechanisms to achieve it, and which interests drew the most benefits from the outcome? Conversely, in case no common position was reached, who was responsible for the dissent, and which interest eventually found satisfaction?

1st version of the Community legislation

Reserving OPT to producers: the actual victory of the Germano-Dutch authorities

The provision concerning Community production is in principle made more restrictive in the 1982 text than in the 1975 version. It is not enough that the beneficiaries of the arrangement be established in the Community, they should also be producers.³¹ This precision is intended to satisfy the vested interest of the Clothing sector whose European federation, ECLA, was strongly opposed in self-defence to allow retailing firms to benefit from the arrangement. Had the provision have been properly applied, the Dutch and the German governments, which were under the very strong pressure of big retailing chains' lobbying activities, would have clearly been among the losers. However, not only was a derogation formally provided for³², but also the interpretation of the rule was quite loose throughout member states. If there is to be a winner and a loser, on this point, it is probably the national authorities as against to the position defended by the transnational federations. As a result the main European retailing companies could (and still can) benefit from the arrangement.

The case of "similar products": the formal victory of national authorities

This is yet another illustration of the failure to exclude retailers from the benefits of the arrangement. Indeed, to render the principle more binding, the 1982 text provides that producers can benefit from the arrangement only if, in their Community plants, they produce goods that are "similar" to those that they re-import after processing.³³ However, the definition of a "similar" product is left unclear. Indeed, shortly after the publication of the OPT legislation in the Official

³¹ Council Regulation 636/82, 16 March 1982, OJ L 76, 20.3.82. Art. 2, 2, (a).

³² Op. cit. Art. 2, 3, 2.

³³ Op. cit. Art. 2, 2, (a).

Journal of the European Communities, the Commission issued a regulation of application which failed to provide any clarification on the matter³⁴.

Here lies the main factor explaining why the principle of the primacy of producers was actually applied very differently throughout member states: the latter could interpret the notion of "similar product" more or less restrictively, according to their own priority. Thus as opposed to the case of the very principle of the exclusion of retailers from the arrangement, there are no winners and no losers. To be precise, there are *only* winners: national authorities, whatever there are, as opposed to supranational entities, be they Euro-groups or the Community itself.

The mechanisms to reach such an outcome are quite uncommon: the latter is not obtained through negotiation, exercise of power, concessions and agreement, but through the absence of confrontation and the *deliberate* unintelligibility of certain crucial provisions.

The origin of the fabrics used in the transaction: the say of Euro-Groups

One area where European federations have voiced their position and influenced the outcome is that of the origin of the goods eligible for the arrangement. Indeed, the textile lobby, as represented through the channel of COMITEXTIL, the European Confederation, the principle that eligible products be of Community origin. In this way, the arrangement was meant to be a very powerful instrument promoting the Textile sector. On the face of it, the Clothing industry argued strongly in favour of an unrestricted use of fabrics of whatever origin. A final agreement was eventually reached. As a concession made by the Textile to the Clothing interests, a derogatory clause was introduced: in case of shortage of Community textile³⁵, it was made possible to incorporate goods of non-Community origin in the temporarily exported goods up to 14% of the total value of the latter.³⁶ This derogation is to be understood as a concession of the Textile sector to the Clothing interest. In exchange, the arrangement was restricted to producers alone: to obtain the principle that the arrangement be reserved to fabrics of Community origin, COMITEXTIL traded off its other objective of extending the benefit of the arrangement to retailing chains and distributors. It is as if COMITEXTIL conceded the production orientation of the arrangement together with the 14% clause to the Clothing lobby, as this latter sector had the most to lose from OPT in terms of level of employment.

Even though the provisions concerning the origin of fabrics used in OPT transactions appear to be designed as the result of the political activity of Euro-groups, they do not necessarily illustrate the pre-eminence of European federations in the OPT decision-making. Indeed, the

³⁴ The regulation is merely concerned with the form of the so-called "Prior Authorisations" necessary for benefiting from the arrangement. See Commission regulation 1828/83, 30 June 1983 (in OJ L 180, 30.7.83).

³⁵ Interestingly enough, the alleged shortage is assessed on the basis of estimates made by Textile Industrial Federations.

³⁶ Op. cit. Art 2, 2, (c).

diverging positions of the two Federations tended to weaken their respective positions rather than to reinforce and combine their bargaining power.

Assessment of the text and of its application

Overall, the Community legislation of 1982 missed its objective of harmonising conditions for undertaking OPT throughout member states. As expected, the Germans had the most liberal interpretation, and almost no restriction was effectively enforced. As in the Netherlands, for example, it was legally possible for traders to undertake OPT activities provided they "symbolically" acquired a producer, responsible for carrying out OPT activities.³⁷ On the contrary, the Italians, but also the Belgians imposed strict controls on OPT operations.³⁸ Yet another area where member states had quite distinct, if not diverging, interpretations of the text is that of the relation between the level of Community production and that of authorised processing abroad. The further South in the Community, the more pegged the two.

2nd version of the Community legislation

As previously hinted, besides the necessity of preserving the competence of the Community in trade-related matters, the coming into force of the Single European Act made even more unacceptable the diverging conditions for undertaking economic OPT in the different Member states, resulting from the imprecision of the 1982 text.

The 1994 text objective was to harmonise positions on the 4 points of contention raised by the 1983 legislation:

- the definition of 'similar' products
- the definition and admission of beneficiaries to the arrangement
- the restriction of the arrangement to producers located within the Community.
- and the management of the 14% derogation clause

'Similar products'

The most notable achievement of the 1994 legislation is that it finally provides for the definition of the highly controversial notion of "similar" products: they are goods which fall into

³⁷This explains the OPT strategies of C&A, Kaufhof, Karlstadt ...

³⁸In Belgium, for example, producers were not allowed to devote more than 30% of their value added to OPT operations, and they could not decrease the level of employment in their plant by more than 90%.

one of the 3 categories defined in an annex.³⁹ Concerning conditions of eligibility, the text introduces precisely defined rules. For example, the tasks that beneficiary producers should perform within their EC factories are specified, and consist in "sewing and assembly, or knitting"⁴⁰. Also, a time limit is imposed on the period during which the processing tasks are supposed to take place in third countries.⁴¹

The case of newcomers to the arrangement

An important novelty presented by the Regulation is the distinction it operates between past beneficiaries and newcomers. The underlying logic is to make the legislation more precise for newcomers, while preserving the rights of past beneficiaries.⁴² Interestingly enough, however, a number of derogations tend to mitigate the divide between the two categories. This is so, for example, for firms in new member states entering the Community, which are allowed to benefit, under certain conditions, from the previous national regime (Austria, most notably).⁴³ Most importantly, the provisions extending the arrangement to retailing companies already engaged in OPT activities before the 1982 regulation is re-conducted.⁴⁴ This is, indeed, a serious infringement to the principle of the restriction of the arrangement to producers alone, which is indeed at the core of the concessions made in the course of the OPT negotiations. Winners are all over still the same: those countries which are particularly prone to a liberal interpretation of the arrangement, and which, this is no coincidence, are those where big retailing companies are based: Germany and the Netherlands.

The definition of 'Community production'

A fundamental innovation in the text, however, has to do with a provision stating that, in the case of newcomers and past beneficiaries asking for additional authorised amounts, the value

³⁹ Council Regulation, 3036/94, 8 December 1994, OJ L 322. Art 1, 4, (e), and Annex I. The 3 categories are: Outwear, Underwear, and Others; each of them corresponds to a list of MFA categories. It is also specified that such similar products must be at the same stage of production than those relocated.

⁴⁰ Op. cit. art 2, 2, (a). Contrary to the earlier Proposals, the "cutting" stage has been ... cut from the actual version.

⁴¹ If the beneficiaries exceed their time limit, they lose irremediably their rights that are recredited for the benefit of newcomers. See op cit. Art 3, 6, parag. 3. It is interesting to note that the competence on the matter is left to national authorities.

⁴² Newcomers have their quotas distributed on a first-come first-served basis, after past beneficiaries have renewed their rights. It is worth noting that some new constraints are nevertheless imposed to past beneficiaries: for example, if past beneficiaries do not fully use their rights, they lose them once for all, with no possibility to transpose them into the following year. If this is the case, they fall under the regime reserved to newcomers. See op. cit. Art 3), 4, 3.

⁴³ Op.cit. Art 2, 3, 3.

⁴⁴ Op. cit. Art 2, 3, 2.

of the goods that undergo processing abroad should be inferior by 50% to the value of the Community production of the former.⁴⁵ In addition, the concerned EU producer should have used at least 50% of the amount previously authorised, or (re)exported 80% of the products which had undergone processing abroad.

The problem is that the definition of 'Community production' is not given. This indeed looks like "dejà-vu". Like the 'similar product' issue, the provision on Community production is crucial in the whole edifice of the text. The same mechanisms as those which obfuscated the plain interpretation of the 1982 text were thus at work in the 1994 text as well.

A Commission Regulation was therefore made necessary; and the fate of the whole text (its degree of bindingness) would depend on it. It was adopted in December 1995, i.e., about 5 months later than what the Commission was hoping.⁴⁶ The objective of defining the meaning of Community production was eventually achieved.⁴⁷ But some minor issues were still left undetermined. This is also true of the provision concerning the reduction of authorised amounts in case of the decreasing employment levels in the Community plants proportional to the undertaking of processing activities abroad. Also, in the case of the preferential treatment granted to CEECs, the regulation of application makes necessary the emission of a prior authorisation. However, the procedure to follow is not provided for.

Assessment of the text and of its application

The introduction of the notion of 'Community production' and its failed definition is a major pitfall, serious enough to incite considering the whole endeavour to be -at least- half a failure. Indeed, besides clarifying old rules, the legislation elaborated new ones which were not necessarily better designed: it was not put an end to the indeterminacy of the text.

What is more, apart from the politics of deliberate vagueness, another reason making the text and its application regulations far from satisfactory has to do with its high degree of technicality. The very cumbersome procedures to follow are likely to dissuade would-be candidates; it is very realistic to think that firms will prefer to face rapidly decreasing trade restrictions rather than to deal with complex and time-consuming administrative tasks.

An important aspect of the new text is that of its apparent restrictive drift. However, any definitive conclusion in this respect should be avoided. First, if it is indeed more difficult for firms to resort to the arrangement, this does not appear to be the result of a deliberate intent. In other words, it does not correspond to an objective of industrial policy taken over by the

⁴⁵ Op. cit. art 3, 5, parag. 2.

⁴⁶ A previous regulation was adopted in July of the same year (OJ L154, 5.7.95), but without addressing the crucial issues at stake in the 1994 basic text.

⁴⁷ Art 2, 4. It is "calculated on the basis of the normal ex-factory exclusive of VAT" of products listed in an Annex.

Commission like slowing down the relocation of production activities outside the Community, and protect the level of employment within the Community. It is rather the direct and 'neutral' consequence of the harmonisation process: defining each single measures as precisely as possible in order to make diverging interpretation difficult, if not impossible.

Second, the question as to whether the text is actually 'more' restrictive should be gauged by comparing the latter not with its predecessor at the Community level, but with the national regimes of application previously enforced in the different member states. A German firm, for example, will find it much harder to resort to OPT under the new text than before 1993; on the contrary, for Italian firms, it is precisely the opposite which is true. Third, and more importantly, the legislation would indeed be made more restrictive were it not for the introduction of the highly controversial provision concerning the beneficiaries' level of Community production (the 50% issue).

3. The winners and the losers

Member states, and in more general terms, the national level of policy-making, went through the process unchallenged by any overt threat of sovereignty transfer at the supranational level. It is important to make a distinction: it is not some member states which obtained satisfaction at the expense of some others. The Germans, say, did not impose their view to the Portuguese; this would indeed mean that the integration process is effective. On the contrary: the German *and* the Portuguese national authorities obtained satisfaction as both of them could eventually implement the policy that best suited their priorities.

The mechanisms to obtain such an outstanding outcome consist in *obfuscating* the plain interpretation of the legislation supposedly providing for the harmonisation of diverging national positions. Whether deliberately maintained, or simply an unintended consequence, the result is the same: ambiguity makes possible different interpretations according to the particular interests at stake in the negotiation. In short, whenever a provision is more or less irreducibly obscure, it is a sign of the failure of the harmonisation process, and, consequently of the centralisation of competence at the supranational level.

On the face of it, supranational entities appear to be the clear losers of the game. The Commission, for example, was not only unable to take advantage of a potentially powerful instrument of industrial policy, i.e., to *actively* impose its own objectives, but it was also unsuccessful in carrying out the more neutral process of harmonisation.

One possible (partial) explanation for the weakness of the Commission is its lack of internal coherence. Indeed, an important point when discussing the autonomy of the

Commission's objective is to address the potential rivalry between the different Directorates General in charge of the OPT legislation. Although the Commission does supposedly act as a collegial body, DGI (external affairs), DGIII (industrial matters), and DGXXI (Custom matters) had distinct positions with respect to the OPT policy. Very broadly, DGI is more concerned with the potential positive effect of OPT on the competitiveness of declining European industries, whereas DGIII is particularly sensitive to the adverse consequences OPT may have on these industries' level of employment. One can thus imagine possible coalitions between the DGs and the member states. For example, DGIII is closer to member states like Portugal, whereas DGI shares very much the same concern on international competitiveness as Germany. Such an internal division within the Commission corresponds to the fundamental dilemma characterising the use of OPT as an instrument of industrial policy. In this debate, DGXXI has a somewhat intermediary position as it tries to achieve a compromise between the antagonism of the other DGs.*

As mentioned above, the initiative to provide for an OPT legislation at the Community level emanates from the Commission. A 'technical committee' within DG XXI in charge of Custom Affairs submitted a proposition endorsed by the Commission** to the Council of Ministers. In principle, if the latter agrees on a favourable opinion, it empowers the Commission for the detailed application of the proposal, while maintaining its prerogatives on the broad lines of the text. The Committee set up by the Commission is then in charge of the application and the proposition is further elaborated as it goes back and forth between the Committee's group of experts, and COREPER.*** In the case of the 1982 revision, however, the Committee did not reach the qualified majority necessary for adopting the proposal, and the latter was sent back to the Council of Ministers.

Nor did Euro-groups prove to be much more efficient. Generally speaking, the two federations representing the textile industry and the clothing sector at the European level COMITEXIL, and ECLA³¹ are weaker than their national counterparts which are more homogenous. Traditionally, however, COMITEXIL benefits from quite a strong bargaining

*The problem with the identification of the DGs' respective alignment is that it comes against to the paucity of systematic evidence.

** The Commission is in principle a collegial body, with a unique position.

³⁰ "Comite des Representants Permanents". In principle, the procedure should also involve the respective competent ministers.

³¹ Mention should be made of the existence of a 3rd federation, MAIEUROPE, representing the European knitting industry separately. The existence of MAIEUROPE does not properly speaking further the divisiveness of the European T&C representation, as it works closely with the powerful COMITEXIL. What is more, according to Cable, it has succeeded in transcending the substantial differences of interest between the export-oriented Italian industry and the others, including the British industry [Cable, 1983: 199].

clout, in particular at the Commission.²² On the OPT issue, COMITEXTIL did indeed reach a common opinion which was favourable. But, the traditional influential weight of COMITEXTIL was seriously limited because of the controversy with ECLA over the restriction of the arrangement to the sole producers. As to ECLA, it is already traditionally weaker than COMITEXTIL for the simple reason that the industry resorts to more diversified and internationalised adjustment strategies. Hence a lower attainable degree of consensus. The conflict with COMITEXTIL did certainly not improve the situation. Indeed, ECLA did not reach a common position on the latest revision of the OPT legislation undertaken by the Commission.²³ In this context, a more thorough accord between ECLA and COMITEXTIL presenting an unified front on the OPT issue is quite unrealistic.²⁴

In dynamic terms, however, the picture is slightly different. Even though ECLA is still partially ineffective in defending the interests of the European clothing sectors as a whole, the Federation has undergone a process substantially strengthening its position on policy matters. This trend is illustrated by the tangible alteration of the original aversion towards offshore processing activities: step by step, the European federation has consolidated a liberal approach to OPT, favouring internationalisation against protection as an appropriate adjustment strategy. But its main objective is still to reserve OPT to *producers*. Whereas, the European clothing federation has, with time, adopted a more liberal political stance, the European textile industry, by the voice of its European federation, has kept on favouring a restrictive interpretation of the OPT arrangement. In particular, it is determined to prevent OPT from applying to fabrics which do not originate in the EC. For COMITEXTIL, OPT has been and is still a device limiting the use of fabrics imported from third countries.

Because of such conflicts, the effectiveness of business representation through the channel of the European federations is not warranted. Thus, firms, and the national industry associations of both textile and clothing had to rely on their respective government to have their interests represented in Brussels. A problem presented by this mode of representation is when there is no alignment between the positions of the national industry and that of the concerned member state's government. In Portugal, for example, the industry's position is favourable to the liberalisation of the access conditions to OPT, whereas the Portuguese government is openly against the arrangement. Thus the Portuguese industry had to go directly to Brussels to defend its view. Another consequence of the imperfect endorsement of industry positions by respective governments is that it renders negotiations in Brussels significantly more complex.

²² By contrast with the positions of COMITEXTIL at the Council of Ministers.

²³ That ECLA did not reach a consensus whereas COMITEXTIL did is not that surprising: it is probably due to the additional divide between retailers and producers in the Clothing sector.

²⁴ EURATEX which is formed by ECLA and COMITEXTIL is indeed conspicuous for its inactivity.

Overall, the legislation on OPT is the product of two series of bargain, between firms and national authorities and between states; on the face of it, representation of business interests through supranational associations proved to be relatively more marginal. It is therefore member states' preferences described in section 2, which is the fundamental motor of the legislation-making process: Germany, backed by the Netherlands pressing for as liberal as possible a regime (with the inclusion into the arrangement of distributors) vs. the UK, taken over later by Southern European countries determined to tightly keep under control the potentially disruptive consequences of OPT on employment in the Clothing sector.

1.3 Conclusion

This Chapter shows how controversial the possible policy attitudes with respect to the relocation issue are. The stake is high and has to do with the options left to policy-makers in the face of the increasing internationalisation of production activities. The bone of contention involves the advocates of relocation to foster international competitiveness and firms' profitability, on the one hand, and those backing protectionist measures in order to preserve domestic employment and to gain foreign exchange, on the other hand. The great merit of OPT in this respect, is that the arrangement makes possible a subtle balance between the two objectives, blurring too clear-cut a choice. Hence the flexibility of the arrangement's interpretation and the purported simultaneous satisfaction of widely diverging interests.

The above account of the legislation-making process showed that no generalisation can be made about hypothetical cutting lines distinguishing between the actors party to the OPT legislation-making process. As a matter of fact, there is a host of discriminating variables which are partially overlapping, and which, in addition, are in constant evolution as time passes by: a strong UK/German opposition, a subsequent North/South divide, an irreducible sectoral distinction between the Textile and Clothing industry and the other sectors, and within the former, between the Textile and the Clothing sectors, and last but not least, numerous individual contrasting positions adopted by big corporations, in particular in the retailing business. To make things worse, because of the intrinsic ambivalence of the arrangement, and the conflicting interpretations it gave way to, OPT policy-making at the Community level triggered a necessary process of harmonisation. This, in turn, further exacerbated and entrenched the positions aligned in the OPT debate.

Overall, among the possible sets of factors influencing the formation of corporate OPT strategies, the OPT legislation is the privileged locus where firms are not only 'determinant-takers', but also, to some extent, 'determinant-makers'. Hence, a 'feed-back' process takes place whereby firms contribute to the formation of the framework of opportunity and constraint within

which they decide on their strategic decisions. In this respect, the above analysis showed that the fundamental motor of the negotiation and the main determinant of the outcome is the bargain between firms and states taking place on a forum provided by the Community institutions and arrangements.

Chapter 2 Regional response: the opening up of CEECs markets

The OPT guiding principles as depicted in Chapter 1 apply to the case of EU firms relocating their activities abroad, irrespective of their geographical destination. The present Chapter investigates the effective constraint and opportunity that the OPT arrangement represents in the specific case of the economic relations between the EU and the CEECs.

The sudden opening up of Central and Eastern European economies as of the demise of the COMECON in 1991 represents an economic opportunity of unprecedented nature in the world economy. It makes available at the same time markets and cheap and qualified labour within an area characterised by outstanding potentials for growth and development. What is more, from a Western European perspective, the geographical and economic distance from these potentially fast-developing markets is reduced, if not negligible.

Thus, the liberalisation of economic transactions between the EU and the CEECs is a strong incentive for firms to extend international production activities throughout the region, and design relocation strategies so as to strengthen their international competitiveness. In the best of the world, OPT enables Community firms to take advantage of CEECs comparative advantage in labour costs by making it possible to relocate those segments of their production process which are the most labour-intensive, and the most subject to international competition.

But this is a half-full glass. To have a complete picture of the constraint and opportunity relevant to the OPT case, it is also necessary to look at the half-empty part. As a matter of fact, the process of trade liberalisation is not tantamount to the establishment all at once of free trade. In the case of the relations between the EU and the CEECs a transition period is expected to last until the year 2000, during which trade is being liberalised in a protracted way. And indeed, as noted in Chapter 1, OPT owes its *raison d'être* to measures of trade protection; more precisely in the case of CEECs, to the *residual existence of trade barriers during the process of trade liberalisation*. This means that Community firms undertake OPT activities where there are such trade barriers. Therefore, CEECs comparative advantages notwithstanding, the OPT activities of EU firms take place where trade barriers are still in place.

The present Chapter weights the respective importance of trade barriers and 'pure' market determinants in the framework of constraint and opportunity relevant to the OPT activities of EU firms in CEECs.

2. 1 Market forces: the comparative advantage of CEECs

The present section is an empirical analysis of the potential market factors underlying the development of OPT relations between the EU and CEECs. Indeed, the demise of the COMECON in 1991 was accompanied by a process freeing economic transactions between the EU and the countries of the former Soviet bloc. Trade liberalisation, one crucial dimension of such process, make supposedly possible the exploitation of CEECs' comparative advantages based on the availability of a quite cheap and relatively skilled labour force, and OPT is an instrument enabling Western producers to take advantage of such potentialities. One is thus tempted to ask where exactly these comparative advantages lie to understand (and predict) where OPT trade between the EU and CEECs develops.

Analytical tools like Revealed Comparative Advantages and Gravity models will be used in the present section to identify the sectoral and geographical opportunities presenting the most interesting potentialities.

1. Revealed Comparative Advantages and Gravity models

In the aftermath of the demise of the COMECON, several studies undertook the task of determining the comparative advantages of CEECs' economies on the basis of indicators of the so-called revealed comparative advantage.³³

Despite the variety of indicators used, and the sometimes discordant results obtained, there are nevertheless some converging findings. One of these is the importance of resource-based products as a source of comparative advantage. In Klodt (1994), and Daviddi (1992), for example, resource intensive goods in general, and fuels in particular, record one of the best performance as measured by RCA indicators³⁴. Graziani (1994), however, shows that non resource-based goods have become prevalent in the 90s as compared to the 80s. The country that has recorded one of the steepest decrease of RCA for resource intensive goods between 1980 and 1992 is indeed Czechoslovakia; Graziani points at this country as the most disadvantaged one in 1991.

Another common feature concerns the relative importance of "basic manufactures" classified in the SITC 6 heading. Graziani (1994) for example, finds that 6 headings out of the 15

³³ See Winters, (1994); Collins, and Rodrik (1991); Daviddi (1992); Rollo, and Smith (1992); Erzan and Holmes (1992); Ebbers and Olson (1994); Graziani (1994); Nagarajan (1995), Fieleke (1990), among others.

³⁴In 1992, and 1990, respectively.

that recorded the highest values of RCA indexes in 1991 are products belonging to that category such as cork and wood, paper, textile, and iron and steel. The latter category is definitely one of the leading products in which CEECs have a strong comparative advantage [Daviddi, 1992; Ebbers and Olson, 1994].

Ebbers and Olson (1994) add chemicals and plastics to the list of best RCA indexes (SITC 5). Halpern (1994) corroborates, and considers chemicals to be by far the strongest pole of competitiveness of the Czechoslovak economy in 1991; it is also one of the categories where the domination of Czechoslovakia over its former partners of the COMECON is the most marked.

Finally, some products are doing well in the SITC 8 heading which comprises mostly apparels and especially footwear [Ebbers and Olson, 1994]. Halpern (1994) shows that although T&C record weak results as compared to other CEECs, they occupy a privileged position with respect to the other Czechoslovak exports.

An interesting feature is the rather bad performance of Czechoslovak trade compared to the other CEECs in the machinery and transport equipment (SITC 7). In Olson and Ebbers (1994), almost all the headings of the category record negative RCA indexes (electrical machinery, for example). However, there are exceptions which vary, depending on the source considered. For Olson and Ebbers (1994), these are road vehicles (SITC 78), and power generating machinery (SITC 71); Graziani (1994) finds certain specific transport equipment (SITC 791), and machinery specialised for particular industries (722); Halpern (1994) would add motor vehicles. The latter computations insist that machinery are characterised by relatively poor performance in the Czechoslovak trade, but not in the case of the CEECs in general. Indeed, the index improved from 1988 to 1991.⁷⁷

This rapid survey of the RCA literature should allow us to draw some conclusions as to the comparative advantage supposedly characterising CEECs. To make general statements on the matter as accurate as possible, synthetic indicators are particularly useful. Graziani (1994), for example, groups the different categories of products according to the characteristics of their production process. He successively weights resource-based vs non resource-based products, mature vs new products, standardised vs unstandardised⁷⁸, and labour vs capital-intensive products. In his findings, the stylised good exported to the EC is no longer resource-based; it is rather a mature, standardised, and labour-intensive product. Moreover, low technology products

⁷⁷ It is important when dealing with machineries to make the distinction between Western and Eastern markets: as a matter of fact, RCA recorded on the basis of trade flows geared to the former COMECON partners, are mostly positive. This is straightforward in Fieleke (1990), for example, but also in Ebbers and Olson (1994).

⁷⁸Product maturity and standardisation are notions that both refer to the product cycle theory. Whereas the former is defined according to the level of skill required in the production of the good, the latter classifies industries according to their low or high rate of product development. An example of new industry is machinery; whereas clothing, footwear, and glassware are mature industries.

dominate CEECs exports. The Czechoslovak economy shows some peculiar features in this broad pattern. Not only it is characterised by the lowest share of resource-based exports to the EC (23% in 1991 as against an average of 33% for the CEECs taken as a whole), but it is one of the rare country that recorded an increase of new products proportion in total exports (achieving a level of 27% in 1991), and it is in absolute terms the country characterised by the highest share of unstandardised products (34% in 1991). There are even some skill-intensive products such as tractors and power generating products are successfully exported by the Czech Republic. The latter is at the same time the country still characterised by the highest proportion of capital-intensive exports (28% in 1991)."

Klodt (1994) provides similar synthetical pieces of information. He computed the RCA of the goods that CEECs traded with Germany in 1980 and 1992, and grouped them into four categories according to the relative factor intensity of their production process; there are resource-intensive, physical capital-intensive, labour-intensive, and technology intensive products. This latter category is itself divided into "mobile-Schumpeter goods", and "immobile Schumpeter goods"⁴⁰. Interestingly enough, the results show that the highest RCA is still recorded by Czechoslovakia in resource-intensive goods; however, as compared to the other CEECs, Czechoslovakia presents the highest RCA in capital-intensive goods, and one of the lowest RCA (together with Hungary) in labour-intensive goods. As to technology-intensive products, they are clearly characterised by negative values of RCA, even though the relative disadvantage is comparatively inferior to that of other CEECs.

Finally, Neven (1995) distinguishes 5 types of industries according to their factor content⁴¹, and computes their respective RCA for the 5 CEECs and the former USSR. The main interest of these data is that they distinguish between CEECs' RCA with respect to Southern Europe and RCA with respect to Northern Europe. Basically, CEECs display a strong comparative advantage in industries that are intensive in both capital and unskilled labour, with respect to both Northern and Southern Europe. Towards Northern countries, the performances are relatively advantageous in labour intensive industries, whereas with Southern European countries, it is goods rather intensive in human capital that are exported successfully.

In general, Neven (1995) finds a consistent pattern of CEECs comparative advantage in low-skilled sectors, and sectors intensive in physical capital. To conclude, he notes that long term comparative advantage lie rather "where a comparative advantage has recently emerged (...), namely in the labour intensive industries".

³⁹This has to be connected to the heavy inheritance of the COMECON specialisation.

⁴⁰See following for their description.

⁴¹These are: high tech goods intensive in human capital, goods intensive in human capital but using little physical capital, goods intensive in unskilled labour, and using little capital, goods intensive in both labour and capital, and goods intensive in both human capital, and physical capital.

Overall, the above findings point at labour-intensive products as the goods for which the CEECs economies has a comparative advantage. With almost a shade of regret, Graziani notes that "cheap labour is still a reality of the CEECs" [Graziani, 1994: 231]. This result is indeed not surprising and is in line with the conclusion reached by an approach more respectful of the theoretical propositions of the HO model.

2. Possible future comparative advantages

Although they converge in identifying labour as a source for comparative advantage, the above-mentioned RCA studies all stress that this is probably only a temporary feature of the CEECs economies. As a veiled recognition of the limitations of the insight gained from RCA indexes, it is often referred to the very intuitive notion of "potential" comparative advantage based on what is generally thought to be the high level of education of CEECs' population. This is the case of CEPR (1990: 9), Hamilton, and Winters (1992: 95), Graziani (1994: 226), Halpern (1994: 21). Equally deemed important are the good R&D capabilities of these countries.

On the basis of a more or less explicit correlation between scientific skills and comparative advantage in mid-tech goods in Western countries, these studies conclude on the likelihood for certain CEECs to become exporters of sophisticated products. The comparative edge in human capital, and R&D capabilities of CEECs in general should, in the long run, be reflected in their trade specialisation. In this view, "from the existing evidence on the 'human capital' potential of the Czechoslovak economy (...), one could conclude that Czechoslovakia could turn into one of the most successful economies of the newly emerging market economies of Eastern and Central Europe" [Landesmann, 1991: 78].

The proponents of such a point of view, however, make clear that this is more likely to materialise with the impetus given by foreign capital: foreign investment is deemed necessary to spur the exports of upgraded value added goods. Klodt (1991, and 1994) refines the argument and distinguishes between high tech goods, which research stage can be geographically separated from the very production process (mobile Schumpeter goods⁴¹), and those high tech goods, which research and production phases can hardly be disentangled from each other (immobile Schumpeter goods⁴²). As NICs managed to attract foreign investment in the former sectors, they also specialised their trade in the corresponding products. So would successful CEECs, with the difference that rather than micro-electronics goods, CEECs would be more prone to specialise in chemicals or software's. As an empirical confirmation of such a view, Klodt provides some

⁴¹E.g. chemicals, office machines, software, and electrical machinery...

⁴²E.g. non-electrical machineries, motorcars, optical goods...

estimation of RCA for both mobile and immobile Schumpeter goods: although both negative, the RCAs of the former are slightly higher than those of technology-intensive and immobile Schumpeter goods.

What is at stake is whether CEECs are able to 'move up markets'. Rather worrying, in this respect, is the finding made by Neven (1995) that CEECs patterns of comparative advantage have scarcely changed over 5 years, even though trade volumes were growing at quite remarkable speed. There is however infinite controversy and uncertainty on the matter. More recently, for example, Landesmann (1997) and Guerrieri (1997) both found consistent evidence of an upgrading process.

3. Comparative advantages and 'sensitive' products

Summing up, CEECs appear to be characterised by interesting potentials in some specific area which are all to some extent connected to the low-income, low-wages features characterising CEECs economies. A major result achieved by the above studies is that CEECs' comparative advantage appear to lay in labour-intensive goods like manufactures (most of them classified in SITC 6): T&C, footwear, wood and paper, iron and steel. Perhaps more unexpected and hazardous predictions concern the likely performance of sectors such as chemical, plastics and software's.

Interestingly enough, there is an apparent correspondence between CEECs comparative advantages as identified above and the so-called "sensitive" products i.e., goods subject to a delayed trade liberalisation schedule (food and agricultural product, T&C, footwear, Iron and Steel)⁴⁴ [Neven, 1995]. Indeed, most of CEECs exports are concentrated in these category. In fact, it is Polish exports which register the highest proportion of sensitive goods, and the former Czechoslovakia which is the least dependent. Hungary which used to have extremely high proportions has seen a marked decrease of her dependence. Overall, the rate of dependence tend to decrease in the 3 countries. However, if the agricultural products are not taken into consideration, the rates of decrease are significantly reduced.

This is a hint suggesting that it would be quite naive to believe that pure market determinants are effectively at work without alteration introduced by 'exogenous' factors like protection measures. Before achieving too hasty conclusions on the imperious incentives presented by comparative advantages, it is therefore worth investigating the influence of trade restrictions still in place during the transition phase towards free trade.

⁴⁴ There is no 'official' definition of what is a sensitive product, but rather a standard agreement. Sometimes Chemicals are added to the list in the name of past anti-dumping action adopted by the Community.

2. 2 Institutional factors: the process of trade liberalisation

The fact that EU trade protection tends to be the most resilient in sectors presenting the highest potentials in terms of trade performances invites to assess the bindingness of the former. All the more so, if the objective is to determine the potential factors influencing the formation of OPT networks. Indeed, OPT owes precisely its *raison d'être* to the permanence of trade barriers before full trade liberalisation to take place in the year 2000.

In this respect, the 'politicisation' of OPT determinants appears to be double-faceted: first directly, the formation of OPT networks owes much to the mode (the speed and the form) of trade liberalisation; and second indirectly, the process of trade liberalisation on which OPT depends is itself ascribable to more general considerations which take their full significance in the context of the political relations between the EU and the CEECs.

1. Historical perspective: the political function of trade liberalisation

Economic transactions between West and East traditionally developed in a very politicised environment. Two contending principles were governing them: the belief in economic interdependence to spur political convergence, and the reliance on economic containment as a political instrument to isolate CEECs [Bertsch, Vogel, and Zielonka, 1991]. The relations between the European Community and Central and Eastern European countries took place in this context. Until 1988, they were characterised by unilateral measures taken by the Community in the framework of a trade regime designed to deal specifically with 'state trading economies'⁴⁵. Apart from unilateralism, a second feature of the EC-CEECs relations was that 'agreements' were adopted by the EC with each CEEC taken separately⁴⁶. Such agreements were most often restricted to particular and restricted issues; they actually used to endorse measures taken at the national level by member states.

On 25 June 1988, a joint declaration between the EC and the COMECON was signed establishing mutual recognition. However, the regime governing trade relations was not upgraded in the hierarchy of trade treatment granted by the EC to third countries. Moreover, due

⁴⁵See EC Regulation 1765/82. One main peculiarity of this regime has to do with the definition of particularly restrictive anti-dumping laws.

⁴⁶The reason was politically motivated. See for example, Benavides in Maresceau, 1989.

to the rapid decay⁶⁷ of the organisation, no measure were implemented to develop closer co-operation. Instead, a series of truly bilateral agreements were signed starting with Hungary as of 1988. Part of the so-called "1st generation agreements" [Daviddi, 1992: 272], they were dealing with economic issues and paved the way for the removal of quantitative restrictions⁶⁸. But most of the measures contained in this first wave of agreement were in turn rendered obsolete by the conclusion of the more ambitious PHARE programme in July 1989; dealing initially with Poland and Hungary, it was subsequently extended to all the former COMECON countries⁶⁹.

To keep up with the pace of change in CEECs, and for the sake of more consistent and systematic scheme of co-operation, the Commission decided in August 1990 to conclude "Europe Agreements" with the CEECs, adopting once more a bilateral formula. They were signed on 16 December 1991 with the CSFR⁷⁰, Hungary, and Poland, then in March and February 1993 with Bulgaria and Romania, respectively. Each of the agreement contains 8 main sections⁷¹, but it is the establishment of a free trade area by the year 2000 which is their central objective. "Interim Agreements" were adopted in March 1992⁷² in order to speed up the coming into force of the trade and trade-related measures contained in the Europe Agreements⁷³. The process of implementation rests on the principle of asymmetry, thereby the EU is committed to fully liberalise CEECs exports by 1997 i.e., 5 years before the complete liberalisation of EU exports to CEECs. It is worth stressing that what is at stake in the economic chapters of the Europe Agreements is the establishment of a free trade area (with the liberalisation of goods, service, persons, and capital), and *not* the implementation of a Custom Union that would require a common external tariff, and possibly harmonised trade policies. In this sense, the Europe Agreements differ substantially from "Association Agreements" the EU has concluded with other countries⁷⁴.

A salient feature of the EAs is that they consider full membership of the CEECs as their ultimate objective. Although of a highly indeterminate form, and despite repeated attempts to

⁶⁷The system de facto stopped existing as of January 1991 when transactions started to be carried out in 'hard currency' and at world price. De jure, the system was officially dismantled in March 1991.

⁶⁸although partial and incomplete, a process was triggered that set the deadline of total liberalisation in 1994 or 1995

⁶⁹The PHARE programme is a joint initiative of the EC Commission and the G24 (OECD members).

⁷⁰New Europe Agreements were signed separately with the Czech Republic and Slovakia after the partition in October 1993.

⁷¹political co-operation, general principles, free movement of goods, movement of labour, movement of capital, economic co-operation, cultural co-operation, financial co-operation.

⁷²In December, and May 1993 for Bulgaria and Romania, respectively. The Interim Agreements are in JO L114, 30/04/1992 for Poland, in JO L115, 30/04/1992 for Czechoslovakia, JO L116, 30/04/1992 for Hungary,

⁷³As a matter of fact, they are 'mixed agreements' i.e., they must be signed by Council of Ministers and each of the member states. This is because they include relative to political co-operation, the movement of persons, etc.

⁷⁴Malta, Cyprus, Turkey...

procrastinate any clear-cut timetable, integration is considered by the Community to be the eventual outcome of the current co-operation scheme. The objective was more clearly restated at the European Council in Copenhagen (June 1993), and a white book is supposed to provide for some guidelines. According to the approach adopted by the European Community, the establishment of a free trade area is the first step in a process intended to culminate in the all-encompassing political integration of CEECs into the European Union. The area defined by the European Union and the Central and Eastern European Countries is thus undergoing a process of integration which is for the moment limited to the establishment of a free trade area.

2. Trade liberalisation in practice: the mechanisms of OPT

If the *raison d'être* of OPT is to alleviate trade barriers, then an immediate consequence flows as far the incentive to resort to the arrangement is concerned. As a matter of fact, how far the recourse to OPT is compelling in order to by-pass trade barriers depends on the bindingness of the latter: in short, the more binding protection on normal trade, the higher the probability that *local firms* use OPT in order to access EU markets. On the contrary, if trade protection is marginal, or if the measures are not binding, there is no point in having them lifted, and there is therefore little incentive to undertake and/or declare OPT.

To understand how effective the incentives to resort to OPT are, the present section assesses the bindingness of trade restrictions imposed on East-West trade.

General schedule of trade liberalisation

Far from establishing free trade all at once, the process of trade liberalisation between the EU and CEECs takes in an uneven and protracted way. As a result, numerous trade protection measures are still constraining trade flows even if they are to be eventually lifted. Such a transition period is designed to last at best 6 years, if only CEECs' exports to the EU are considered, and 10 years if EU exports to the CEECs are also taken into account; during this transition period, the major CEECs' exports face "substantial" tariffs and non-tariffs barriers [Messerlin, 1993: 12].

In the following, the identification of trade protection measures still in place during the transition process will pave the way for the assessment of their bindingness.

The entry into force of the Interim Agreements marks the liberalisation of a significant part of the barriers constraining trade between the EU and the associated countries. The remaining trade obstacles are expected to undergo progressive elimination according to a precise schedule. As far as tariffs are concerned, the Europe Agreements provide for the abolition of about half of them upon the entry into force of the Interim Agreement on 1 March 1992. At the Copenhagen European Council held in June 1993, it was decided that the majority of the remaining half would be eliminated no later than 1 January 1995, instead of 1997 as previously agreed. As to quantitative restrictions, they were in principle lifted in 1992; however, textile and clothing MFA products, together with CSCE products are subject to quota (at least until 1997). As far as Outward Processing Traffic is concerned, textile and clothing MFA products that are eligible for the arrangement benefit from a complete exemption of tariff as of the entry into force of the Interim Agreements.⁷⁵ Moreover, quantitative restrictions specific to OPT in the T&C sector will be completely eliminated by 1 January 1998. It goes without saying that no duties will be any longer associated with OPT when tariffs will be themselves completely eliminated (on 1 January 1995). It means that OPT figures are no longer available as of 1 January 1995 for products subject to tariffs⁷⁶, and as of 1 January 1998 for T&C products still subject to quantitative restrictions⁷⁷. Table 1 gives the detailed schedule of liberalisation as provided for by the Europe Agreements, and the Copenhagen declaration.

⁷⁵See Interim Agreement OJ L 115, 30.4.92, Protocol 1, Art 3.

⁷⁶I.e., corresponding to the 'tariff OPT' regime ...

⁷⁷ ... i.e., corresponding to the 'economic OPT' regime. See Chapter 1.

Table 1. Trade liberalisation schedule

| Products | Obstacles | Interim Agreements | Liberalisation path | Copenhagen | Elimination |
|--|---|---|---|--------------------------------------|-------------|
| Sensitive industrial products (Annex IIa) | custom duties | abolished at the end of the 1st year after the entry into force of the Agreement. | reduced by 50% in 92 | / | end 1992 |
| Sensitive industrial products (Annex IIb) | custom duties | abolished at the end of the 4th year after the entry into force of the Agreement. | reduced by 20% per year | abolished at the end of the 2nd year | end 1993 |
| Sensitive ind prdcts (GSPconsolidation; Annex III) | custom duties within tariff quota or ceiling | abolished at the end of the 5th year | annual reduction of 15% | abolished at the end of the 3rd year | end 1994 |
| Sensitive ind prdcts (GSPconsolidation; Annex III) | quota or ceiling for the application of quota | abolished at the end of the 5th year | increased by 20% per year | increased by 30% | end 1994 |
| Agricultural products (Annex XIa) | levies / duties quotas | | reduced by 60% ... increased by 10% from 3rd year ... | 6 months earlier | |
| textile products (Protocol 1) | custom duties | abolished at the end of the 6th year | | abolished at the end of the 5th year | end 1996 |
| textile products (Additional Protocol) | quantitative restrictions | | | | end 1997 |
| ECSC steel products (Protocol 2) | custom duties | abolished at the end of the 5th year | 1st reduction of 80% on entry into force. | abolished at the end of the 4th year | |
| Processed agric. products (Protocol 3) | custom duties | | | | |
| OPT | custom duties | | | exemption as of beginning 1994 | |

Source: Official Journal of the European Communities, various issues. Own elaboration.

The effectiveness of OPT measures: quota vs tariffs

As shown in Chapter 1, since there are two types of protection measures (quota and tariffs), there are two OPT regimes which differ according to the type of preferential treatment they grant: additional specific OPT quota, and partial/total tariff suspension. This is of wide

relevance as far as the incentives to resort to OPT are concerned. As a matter of fact, being quota and tariff differently 'binding', their associated preferential OPT treatment are differently 'attractive'.

The effect of tariffs on trade can be shown to be less binding and less distorting than that of quota. This means that whenever the protective device used is a tariff, the incentive to use OPT is lower than if a quota were enforced.

Trade liberalisation in the Textile and Clothing sector

1. Early measures

Before embarking on the assessment of the restrictiveness imposed to CEECs' exports of T&C during the current transition period, it is worth addressing the impact of previous trade liberalisation in the sector of T&C.⁷⁹ It is important to stress that trade liberalisation in the sector takes place outside the framework provided for by the Europe Agreements, and within that of the Multi-Fiber Arrangements (MFA). The 4th round of the MFA (negotiated under the auspices of the GATT) provides for quantitative restrictions imposed by the European Community to the CEECs through bilateral agreements from 1987 to 1997⁸⁰. On the basis of the conclusion of the Uruguay Round, it was decided to dismantle the MFA regime with the achievement of free access to EC markets as of 1 January 1998.⁸¹ Quantitative restrictions have been thus increased in four waves: in 1987, January 1991 (for Czechoslovakia), April 1992, and December 1992.⁸²

Being considered to be a 'sensitive' sector, T&C is subject to a specific regime of liberalisation which is slower than that scheduled in other sectors by the Europe Agreement; the aim is to prevent cheap CEECs exports from putting at risk the interests of EU producers by being liberalised too suddenly. Such an explicit objective notwithstanding, several studies agree to conclude that quantitative restrictions have been significantly relaxed since the demise of the CMEA. All the indicators of the bindingness of EC quantitative restrictions imposed on CEECs T&C exports by Nagarajan (1995), for example, bring about the same conclusion: the significant liberalisation of the constraints imposed on CEECs exports in general, and on Czechoslovak

⁷⁹ Because of only seriously limited data are made available by the Commission, the following analysis will take the Czech example as a case in point showing how the structure of trade protection can impact on the decision to undertake OPT.

⁸⁰ Initially limited to the 87-91 period, the MFA IV regime was successively extended to December 92, then to December 93 and eventually to 1 January 1998.

⁸¹ Additional Protocol on T&C in OJ L 123, 17.5.94, Agreed Minute N°5.

⁸² Concerning Czechoslovakia (and then the Czech Republic), quota for 87-91 are in OJ L 387, 31.12.86; quota for 1991 in OJ L 45, 20.2.92; and (revised) quota for 1993-1997 in OJ L 123, 17.5.94.

exports in particular. One of such indicators, the trade coverage ratio of quotas imposed by the EC on Czechoslovak T&C exports has decreased significantly since 1989 (Table 2).¹²

Table 2. Czechoslovak T&C exports under quotas in % of total T&C exports.

| 1986 | 1989 | 1992 |
|------|------|------|
| 69% | 64% | 57% |

Source: Nagarajan, 1995.

Another series of indicator, the number of binding¹³ quotas, shows that there is a decreasing number of them imposed on Czechoslovak exports. Whereas there were 57 binding quotas in 1986, there was only one left in 1992¹⁴. As to the average quotas utilisation rate (QUR), it fell from 102% in 1989 to 39% in 1992 [Corado, 1995].¹⁵ Interestingly enough, 'variation coefficients'¹⁶ computed by Corado displays a decrease from 53% in 89 to 35% in 1992.

Finally, a more synthetic indicator is given by the amount of exports which are actually bounded by quota compared to total exports. Table 3 shows that exports under binding quotas decreased dramatically. In 1992 they account for less than 0,5% of total T&C exports and for slightly less than 1% of exports under quotas.

Table 3. Czechoslovak T&C exports under binding quotas as a % of ...

| | 1986 | 1989 | 1992 |
|----------------------|------|------|------|
| tot T&C exports | 52% | 41% | 0,5% |
| T&C exp. under quota | 76% | 64% | 1% |

Sources: Nagarajan, 1995

There are several problems with the above analysis: first with the indicators and their inherent shortcomings¹⁷, and then with the general interpretation to draw from them. For example, neither the trade coverage indicators, nor the quotas utilisation rates are entirely satisfactory indicators: whereas the proportion of exports under quota does not tell much about

¹² The same indicator computed as a percentage of MFA exports of clothing yields higher values: 81% in 1989, and 68% in 1992. See Corado (1994: 28).

¹³ It is commonly agreed that a "binding" quota has an utilisation rate of more than 90% (see Erzan and Holmes, 1992).

¹⁴ *European Economy*, Supplement A #7, July 1994, p 9.

¹⁵ However, other sources find an average QUR in 1992 of approximately 47%. See Op. cit., p 9, Nagarajan (1995: 21) and CITH OSCE, 1992).

¹⁶ Defined as QURs' standard deviation divided by AQURs.

¹⁷ For a technical account of the difficulties that are associated with the interpretation of such indicators, see Nagarajan, 1995.

the actual bindingness of the imposed quotas, quotas utilisation rates tend to bypass the question of the overall impact of quotas on total trade.

It worth noting, moreover, that the average figure for QUR may hide substantial differentiated situations. For example, Germany, and Italy tend to impose more binding quota than other EC partners. What is more, there are products that are more subject to binding restrictions than others: in particular cotton, whether processed, knitted or in fabrics.

Lastly, consideration should be given to tariffs pertaining to T&C exports from the CEECs. They are in average relatively high (12,4% for the 5 CEECs between 1985 and 1989, 17,3% for Czechoslovakia⁴⁸), and what is more, they are higher in sectors where CEECs exports are most dynamic. As to GSP preferences⁴⁹, only few categories are characterised by GSP limits lower than MFA quota [Messerlin, 1993: 40].

2. Consequences on trade specialisation

More fundamentally, it should be made clear that the indicators of trade restrictiveness adopted until now allow to answer only quite a narrow set of questions: whether the *trend* of trade obstacles is geared toward more or less bindingness. Given that liberalisation is the general objective, there is no real surprise with the findings. What is of particular interest, instead, is the real grip trade constraints have on actual trade. The above-analysis does not help answering such a question as it does not say much about the effects of trade obstacles on the structure of actual trade flows.

In his study on the impact of the EU trade policy with CEECs, Messerlin brings in additional elements necessary to complete the analysis [Messerlin, 1993]. It is argued that enlarging quota do not necessarily translate into more unbiased patterns of trade. For example, attention should be paid to the sector where the increase takes place, and to equivalent preferences granted simultaneously to other CEECs; an empirical illustration is that between 1985 and 1989, EU quota in Group I of the MFA categories (consisting of the most sensitive products) were scarce, and to be divided by all the CEECs, whereas Group III was characterised by relatively large quota granted to barely more than two CEECs at the same time.

The share of one country in the quota granted by the EU to the CEECs is indeed an important variable influencing the effect of quota increase. If the share is very large, it invites the beneficiary to take advantage of the associated market power rather than filling the quota. Conversely, very small quota shares, generate dissuasive transaction costs.⁵⁰ In both cases, the

⁴⁸ See Messerlin, 1993: 56.

⁴⁹ Consisting of tariff quota and ceilings.

⁵⁰ Messerlin actually distinguishes between level and evolution analyses: he demonstrates that whether an increase in one CEEC quota together with a decline of the CEEC quota share leads to an unambiguous decline of quota utilisation rate, an increase in one CEEC quota together with an increase of the CEEC quota share brings about an indeterminate outcome. Op. cit.: 47.

result is a low quota utilisation rate (QURs). Messerlin notes that it is precisely the case of quotas covering the 85-89 period: quota granted were either very small (in Group I), or very large (in group III).⁹¹ Other factors influencing the outcome associated with quota increase have to do with the industrial structure of the concerned sectors. Everything else being equal, comparatively small outlets may favour a lower fulfilment of quota, thus yielding lower QURs.

All these are likely reasons explaining the decrease of CEECs' QURs following the increase of quota which took place in 1987⁹². In this light, some concern is also justified regarding the subsequent increases of quota on the 89-92 period: if they were on average very significant, thus reducing the previous strong discrimination against CEECs, their uneven distribution and growth rates do not rule out distortions of the kind described above.

Overall, the above considerations show the additional distortions quota enlargement can bring about. They also highlight how controversial can be the interpretation of the QUR indicator, whose low levels should not be taken as an unconditional sign of the unbindingness of quantitative restrictions: the question is of importance since further quota increases are negotiated on the basis of past utilisation. In short, Messerlin's analysis makes clear that increasing quota is not an innocent move merely aimed at lifting distortions: in certain sectors, and under certain conditions it can influence CEECs' trade performance, thus illustrating

"the ability of the general architecture of the EC MFA regime to shape the Central European countries export performance" [Messerlin, 1993: 47].

3. Toward free trade

Assessing the present bindingness of quantitative restrictions in the light of the above considerations shows that, some weaknesses notwithstanding, liberalisation of 'normal' quotas is now an irreversible process. On the face of it, the specific OPT regime seems to have taken over as a source of potentially strong distortions, thus materialising the concern expressed by Messerlin (1993: 51).

a. Direct trade

There are 24 quotas presently imposed on direct trade from the Czech Republic, and this will be so until 1997 (they were 46 from 1991 to 1993, and 26 in 1994). Originally, quotas on direct trade displayed regular growth rates over the 1993-1997 period [Table 1 in Annex 1]: quotas were supposed to increase at an average rate of 21%, with lower peaks in the categories

⁹¹ A graph establishes a positive relation between these shares and the level of QURs. Op. cit.: 54.

⁹² op.cit.: 44.

of woven fabrics (8% only). However, following the entry of EFTA countries (notably Austria) into the EU as of January 1994, quotas were readjusted. Eventually, the actual average growth on the period from 1993 to 1997 amounts to 61%, with higher peaks of +109% (in the category of men's jackets).

As to the distribution of direct quotas, with the exception of two categories which are granted particularly high quantities (woven fabrics, and stockings), it is relatively even [Table 2].

There was one binding quota as defined by Erzan and Holmes²³ in 1994 (they were 12 in 1991). As to Quota Utilisation Rates, they range from 8% (men's suit) to 92% (woven fabrics) in 1994, following a decreasing trend almost entirely concentrated between 1991 and 1992: from a level of 71% in 91, average quota utilisation rate stabilised at the relatively low levels of around 45% in the following years [Table 3].

On the basis of these preliminary evidences, quantitative restrictions imposed on the former Czechoslovakia do not appear to be significantly binding. However, before drawing a definitive conclusions, their effect in relation to the structure of specific quotas imposed on OPT trade is to be further investigated.²⁴

b. OPT trade

The imposition of EU-wide specific quota pertaining to OPT has brought about some significant distortions in the trade liberalisation process. Until 1991 subject to the 'autonomous' trade regime (i.e., provided for unilaterally at the level of each member states), OPT was for the first time included into bilateral agreements with the CEECs in parallel with the conclusion of the more all-encompassing trade provisions of the Europe Agreements.²⁵ Specific OPT quota, endorsed by the Community were thus imposed as of 1 January 1992 [Table 4]. There are 12 of them imposed on Czechoslovakia, then on the Czech Republic; no decrease in the number of quota is provided for.²⁶ The growth of OPT quota was substantially modified as a result of the membership of Austria. Whereas they were supposed to grow at an average rate of +31% between 1993 and 1997, additional quantities granted over the 1995-97 period brought the figure to +52%. This is lower than the increase characterising quota on direct trade (+52% as opposed to +61%). Of particular significance is the fact that the average rate of growth conceals some significant disparities (the strongest growth of OPT quota is +89% for men's suits, the lowest is +36% for men's shirts).

²³ I.e., which quota utilisation rates are superior to 90% (see Erzan, Holmes, 1992).

²⁴ What is more, there can be possible distortions arising from other sources related to some characteristic intrinsic to the concerned products like quality problems. See, for example, Business Central Europe (April 1994: 21). Concerning the low utilisation of quota on farm products, see The Financial Times, July 5, 1995.

²⁵ One of the main difference is that OPT can be subject to negotiation.

²⁶ For Czechoslovakia, in OJ L 45, 20.2.92.

Another way to characterise the situation of OPT quota is to compare OPT with direct quota following the EFTA adjustment,⁷⁷ for example, thanks to an indicator such as the proportion of OPT quota in total quota [Table 7]. OPT represents 55% of total quota in 1993, and 51% in 1997. OPT quotas thus undergo an average decrease of their proportion in total quota amounting to approximately -7% over the 1993-97 period; the rate is broken down in the following way: -1,5% from 1993 to 1994, and -4% from 1994 until the abolishment of quantitative restrictions in 1998. These average figures conceal very significant disparities. Category 12 (stockings), for example, display variations of more than 30% in both directions, overall, the share is stable at around 30%. On the face of it, the share of each category in the total OPT quantitative restrictions remains relatively stable [Table 5].

First analyses tackling OPT found utilisation rates lower than those pertaining to direct trade. For example, the average QUR by Czechoslovakia in 1992 which amounts to 47% is broken down in the following way: the average QUR is 50% on direct exports, and 36% on OPT exports [European Commission, 1994: 9]. But on the basis of figures expressed in tons, Messerlin finds an utilisation rate of total quota amounting to 92,6%, which divides into 48,7% for OPT, and 105,6% for direct trade [Messerlin, 1993: 79]. Table 6 finds yet different figures but agrees on lower OPT utilisation rates in 1992: 38% in average (from OETH sources) which compares with 44% for quotas on direct trade. There were one binding quota.

Interestingly enough, in 1993 and 1994, OPT quotas are suddenly extensively utilised with average above 100%.⁷⁸ There are 8, then 9 binding quotas on a total number of 12 quotas. Overall, quota utilisation rates increased at the rate of + 9% from 1993 to 1994. These figures compare with average utilisation rates of direct quotas which do not go beyond 50% in 93 and 94 (and even decreased by 4,5% on the same period). Indeed, comparing the growth of licences and that of quotas from 1993 to 1994 (on the basis of figures expressed in tons) yields a straightforward result: whereas the former grew at a rate of +13%, the latter recorded an increase of only 7% [Corado, 1995].

But it is the comparison between the growth of OPT quota and that of quota on direct trade broken down on an yearly basis which is the most worrying [Table 8]. First, it appears that the increase of quantitative restrictions is concentrated between 1994 and 1995, as the result of the EFTA enlargement. What is more, there are large variations in the respective growth rates of OPT and direct quota; as a rule of thumbs, the former tend, on a yearly basis, to be higher than the latter.

⁷⁷ Before the adjustment, Messerlin found proportions of OPT quota in total quantitative restrictions growing at non negligible pace: between 1992 and 1997, from 62,8% to 70,9% for Hungary, from 57,5% to 59,4% for Poland, and from 47,8% to 53,2% for Czechoslovakia.

⁷⁸ The maximum theoretical rate is 113,5% for the agreements of 1986 (taking into account all the possibilities of transfers) (see Messerlin, 1993: 42).

Overall, the structure of trade protection imposed, respectively, on direct and OPT trade provides significant incentives to undertake OPT at the expense of direct trade.

2.3 Conclusion

The finding of the Chapter is that the pattern of trade liberalisation between the EU and CEECs is a primary source of opportunity and constraint influencing the terms of economic interdependence between the two areas.

This is of particular salience as far as OPT is concerned. Even if the opportunity offered by a sudden apparent availability of an abundant cheap and skilled labour force is without contest crucial in the formation of EU firms' OPT strategies, it is strongly confined within the limits set by the form and the speed of the process of trade liberalisation.

So much so that, in fact, the development of OPT between the EU and CEECs is ascribable as much to trade protection measures still in place during the transition period towards free trade, than to compelling market forces such as wage differentials. Further, one might even consider CEECs' comparative advantages to be only an 'indirect' determinant of OPT. Indeed, OPT takes place *primarily* where there are trade barriers. But since trade barriers themselves are mainly where such comparative advantages lie, it happens that OPT trade takes also place along their lines.

Thus, the OPT case illustrates that 'opening up' CEECs markets, i.e., in principle freeing market forces, is, in fact, not neutral. It is a rich source of constraint and opportunity which has an active influence on CEECs trade specialisation and on the intra-regional division of labour. The present Chapter invites therefore to challenge the predictions of mainstream economic theory according to which foreign trade in general, and OPT in particular, takes place along the lines of comparative advantage as trade is being liberalised.

Overall, OPT is a striking illustration of the 'politicisation' of economic relations between CEECs and the EU, arising from the fact that the pace and the form of the liberalisation process have a direct effects on trade specialisation, but also because, in the last resort, trade liberalisation itself takes place in the context of the wider historical relations between the Community and the countries of the former Soviet bloc.

Annex 1: The bindingness of trade restrictions during the transition towards free trade
-The example of the former Czechoslovakia

Table 1. Direct Quota imposed on the former Czechoslovakia.

| Direct quotas. | | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | Growth | Growth(*) |
|----------------|---------|-------|-------|---------|--------|-------|-------|-------|--------|-----------|
| MFA | unit | | | | | | | | | |
| 1 | t | 498 | | | | | | | | |
| 2 | t | 9216 | 13900 | 13762.5 | 14038 | 17577 | 17929 | 18287 | 33% | 8% |
| 2a | t | 3577 | 6950 | 5662.5 | 5776 | 7817 | 7974 | 8133 | 44% | 8% |
| 3 | t | 2306 | 5350 | 4622 | 4807 | 5253 | 5463 | 5682 | 23% | 17% |
| 3x | t | 296 | | | | | | | | |
| 4 | 1000pcs | 3004 | 5700 | 5920 | 6157 | 8068 | 8390 | 8726 | 47% | 17% |
| 5 | 1000pcs | 1842 | 4750 | 3249 | 3379 | 4303 | 4475 | 4654 | 43% | 17% |
| 6 | 1000pcs | 1186 | 3500 | 2475 | 2574 | 4336 | 4509 | 4689 | 89% | 17% |
| 7 | 1000pcs | 300 | 1600 | 1152 | 1198 | 1757 | 1828 | 1901 | 65% | 17% |
| 8 | 1000pcs | 1109 | 6000 | 4392 | 4524 | 5592 | 5760 | 5932 | 35% | 13% |
| 9 | t | 907 | 1300 | 1392 | 1448 | 1861 | 1935 | 2013 | 45% | 17% |
| 12 | 1000prs | 8397 | 23000 | 12000 | 12600 | 18989 | 19939 | 20936 | 74% | 22% |
| 13 | | 2841 | | | | | | | | |
| 14 | | 255 | | | | | | | | |
| 15 | 1000pcs | 577 | 1300 | 630 | 661.5 | 1069 | 1122 | 1178 | 87% | 22% |
| 16 | 1000pcs | 502 | 1400 | 1000 | 1050 | 1759 | 1847 | 1949 | 95% | 22% |
| 17 | 1000pcs | 476 | 1150 | 320 | 339 | 596 | 632 | 669 | 109% | 26% |
| 18 | | 585 | | | | | | | | |
| 19 | | 25107 | | | | | | | | |
| 20 | t | 1206 | 2400 | 1512 | 1603 | 2454 | 2601 | 2757 | 82% | 26% |
| 21 | | 582 | | | | | | | | |
| 24 | 1000pcs | 3048 | 4500 | 1550 | 1627.5 | 2860 | 3003 | 3153 | 103% | 22% |
| 26 | 1000pcs | 515 | 1600 | 1000 | 1000 | 1889 | 1984 | 2083 | 108% | 22% |
| 31 | | 1131 | | | | | | | | |
| 32 | t | 2829 | 3900 | 3861 | 4093 | 4422 | 4688 | 4969 | 29% | 26% |
| 32x | | 2472 | | | | | | | | |
| 33 | | 571 | | | | | | | | |
| 36 | t | 1338 | 1650 | 1134 | 1191 | 1536 | 1612 | 1693 | 49% | 22% |
| 37 | | 2451 | | | | | | | | |
| 39 | t | 1097 | 1350 | 954 | 1011 | 1368 | 1450 | 1537 | 61% | 26% |
| 41 | | 186 | | | | | | | | |
| 61 | | 861 | | | | | | | | |
| 66 | | 1087 | | | | | | | | |
| 66x | | 379 | | | | | | | | |
| 67 | | 961 | 1400 | | | | | | | |
| 67x | | 580 | | | | | | | | |
| 67y | | 126 | | | | | | | | |
| 69 | | 1059 | | | | | | | | |
| 73 | | 700 | | | | | | | | |
| 76 | t | 1059 | 3500 | 1387.5 | 1471 | 2458 | 2606 | 2762 | 99% | 26% |
| 90 | t | 2289 | 3500 | 3234 | 3428 | 4022 | 4263 | 4519 | 40% | 26% |
| 91 | | 2600 | 2600 | | | | | | | |
| 110 | t | 3103 | 3500 | 3465 | 3673 | 4101 | 4347 | 4608 | 33% | 26% |
| 117 | t | 2634 | 3050 | 2880 | 3053 | 3394 | 3598 | 3814 | 32% | 26% |
| 118 | t | 596 | 1050 | 1035 | 1097 | 1225 | 1299 | 1377 | 33% | 26% |
| Average growth | | | | | | | | | 61% | 21% |

1991 and 1992: for Czechoslovakia, then for the Czech Republic only.

(*) 1993-1997, without taking into account the revision due to NAFTA membership

"Working levels" for 1993 are well above the OJ figures. For 1994, only 2 categories differ.

Table 2. Structure of direct quota imposed on the former Czechoslovakia.

| Direct quotas. | | | | | | | |
|----------------|------|------|------|------|------|------|------|
| MFA | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
| 1 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 2 | 9% | 13% | 18% | 17% | 16% | 16% | 15% |
| 2a | 4% | 6% | 7% | 7% | 7% | 7% | 7% |
| 3 | 2% | 5% | 6% | 6% | 5% | 5% | 5% |
| 3x | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| 4 | 3% | 5% | 8% | 8% | 7% | 7% | 7% |
| 5 | 2% | 4% | 4% | 4% | 4% | 4% | 4% |
| 6 | 1% | 3% | 3% | 3% | 4% | 4% | 4% |
| 7 | 0% | 1% | 1% | 1% | 2% | 2% | 2% |
| 8 | 1% | 5% | 6% | 6% | 5% | 5% | 5% |
| 9 | 1% | 1% | 2% | 2% | 2% | 2% | 2% |
| 12 | 9% | 21% | 15% | 15% | 17% | 18% | 18% |
| 13 | 3% | 0% | 0% | 0% | 0% | 0% | 0% |
| 14 | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| 15 | 1% | 1% | 1% | 1% | 1% | 1% | 1% |
| 16 | 1% | 1% | 1% | 1% | 2% | 2% | 2% |
| 17 | 0% | 1% | 0% | 0% | 1% | 1% | 1% |
| 18 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 19 | 26% | 0% | 0% | 0% | 0% | 0% | 0% |
| 20 | 1% | 2% | 2% | 2% | 2% | 2% | 2% |
| 21 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 24 | 3% | 4% | 2% | 2% | 3% | 3% | 3% |
| 26 | 1% | 1% | 1% | 1% | 2% | 2% | 2% |
| 31 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 32 | 3% | 4% | 5% | 5% | 4% | 4% | 4% |
| 32x | 3% | 0% | 0% | 0% | 0% | 0% | 0% |
| 33 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 36 | 1% | 2% | 1% | 1% | 1% | 1% | 1% |
| 37 | 2% | 0% | 0% | 0% | 0% | 0% | 0% |
| 39 | 1% | 1% | 1% | 1% | 1% | 1% | 1% |
| 41 | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| 61 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 66 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 66x | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| 67 | 1% | 1% | 0% | 0% | 0% | 0% | 0% |
| 67x | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 67y | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| 69 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 73 | 1% | 0% | 0% | 0% | 0% | 0% | 0% |
| 76 | 1% | 3% | 2% | 2% | 2% | 2% | 2% |
| 90 | 2% | 3% | 4% | 4% | 4% | 4% | 4% |
| 91 | 3% | 2% | 0% | 0% | 0% | 0% | 0% |
| 110 | 3% | 3% | 4% | 4% | 4% | 4% | 4% |
| 117 | 3% | 3% | 4% | 4% | 3% | 3% | 3% |
| 118 | 1% | 1% | 1% | 1% | 1% | 1% | 1% |
| | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

1991 and 1992: for Czechoslovakia, then for the Czech Republic only.

(*) 1993-1997, without taking into account the revision due to NAFTA member

Table 3. Utilisation of direct quota imposed on the former Czechoslovakia.

| Direct Trade | | | | | | | | | | | | |
|--------------|---------|-------|---------|---------|-------|---------|---------|-----------|--------|---------|-----------|--------|
| MFA | 1991(1) | | | 1992(2) | | | 1993 | | | 1994 | | |
| | license | quota | % | license | quota | % | license | quota (3) | % | license | quota (3) | % |
| 1 | 296 | 498 | 59.44% | | | | | | | | | |
| 2 | 9620 | 9216 | 104.38% | 7530 | 13900 | 54.17% | 9146.23 | 14794.6 | 61.82% | 11642.1 | 14038 | 82.93% |
| 2a | 3033 | 3577 | 84.79% | 3920 | 6950 | 56.40% | 4447.15 | 6131.63 | 72.53% | 4273.46 | 5776 | 73.99% |
| 3 | 1923 | 2306 | 83.39% | 2117 | 5350 | 39.57% | 2555.2 | 4968.68 | 51.43% | 2744.35 | 4807 | 57.09% |
| 3x | 269 | 296 | 90.88% | | | | | | | | | |
| 4 | 2157 | 3004 | 71.80% | 2957 | 5700 | 51.88% | 2178.9 | 6330.4 | 34.42% | 2815.67 | 6157 | 45.73% |
| 5 | 2275 | 1842 | 123.51% | 2291 | 4750 | 48.23% | 1634.8 | 3492.68 | 46.81% | 1321.98 | 3379 | 39.12% |
| 6 | 1575 | 1186 | 132.80% | 1936 | 3500 | 55.31% | 753.908 | 2648.25 | 28.47% | 911.897 | 2574 | 35.43% |
| 7 | 80 | 300 | 26.67% | 326 | 1600 | 20.38% | 294.51 | 1238.4 | 23.78% | 312.273 | 1198 | 26.07% |
| 8 | 1493 | 1109 | 134.63% | 2171 | 6000 | 36.18% | 1452.31 | 4721.4 | 30.76% | 1748.38 | 4524 | 38.65% |
| 9 | 781 | 907 | 86.11% | 841 | 1300 | 64.69% | 766.183 | 1504.32 | 50.93% | 816.561 | 1448 | 56.39% |
| 12 | 7451 | 8397 | 88.73% | 10320 | 23000 | 44.87% | 6995.82 | 12993.6 | 53.84% | 6127.78 | 12600 | 48.63% |
| 13 | 702 | 2841 | 24.71% | | | | | | | | | |
| 14 | 126 | 255 | 49.41% | | | | | | | | | |
| 15 | 434 | 577 | 75.22% | 483 | 1300 | 37.15% | 145.61 | 682.65 | 21.33% | 198.674 | 661.5 | 30.03% |
| 16 | 280 | 502 | 55.78% | 261 | 1400 | 18.64% | 104.104 | 1063 | 9.79% | 84.059 | 1050 | 8.01% |
| 17 | 482 | 476 | 101.26% | 526 | 1150 | 45.74% | 55.577 | 345.875 | 16.07% | 65.607 | 339 | 19.35% |
| 18 | 377 | 585 | 64.44% | | | | | | | | | |
| 19 | 15359 | 25107 | 61.17% | | | | | | | | | |
| 20 | 1388 | 1206 | 115.09% | 1317 | 2400 | 54.88% | 759.447 | 1632.96 | 46.51% | 793.81 | 1603 | 49.52% |
| 21 | 179 | 582 | 30.76% | | | | | | | | | |
| 24 | 2984 | 3048 | 97.90% | 2155 | 4500 | 47.89% | 868.426 | 1675.55 | 51.83% | 863.776 | 1627.5 | 53.07% |
| 26 | 257 | 515 | 49.90% | 234 | 1600 | 14.63% | 84.616 | 1072 | 7.89% | 190.521 | 1050 | 18.14% |
| 31 | 467 | 1131 | 41.29% | | | | | | | | | |
| 32 | 1628 | 2829 | 57.55% | 1553 | 3900 | 39.82% | 2418.76 | 3799.19 | 63.67% | 4387.43 | 4788.81 | 91.62% |
| 32x | 1334 | 2472 | 53.96% | | | | | | | | | |
| 33 | 465 | 571 | 81.44% | | | | | | | | | |
| 36 | 639 | 1338 | 47.76% | 640 | 1650 | 38.79% | 517.207 | 1227.56 | 42.13% | 414.149 | 1191 | 34.77% |
| 37 | 1161 | 2451 | 47.37% | | | | | | | | | |
| 39 | 1043 | 1097 | 95.08% | 975 | 1350 | 72.22% | 700.491 | 1030.55 | 67.97% | 618.309 | 1011 | 61.16% |
| 41 | 182 | 186 | 97.85% | | | | | | | | | |
| 61 | 201 | 861 | 23.34% | | | | | | | | | |
| 66 | 388 | 1087 | 35.69% | | | | | | | | | |
| 66x | 539 | 379 | 142.22% | | | | | | | | | |
| 67 | 686 | 961 | 71.38% | 777 | 1400 | 55.50% | | | | | | |
| 67x | 282 | 580 | 48.62% | | | | | | | | | |
| 67y | 70 | 126 | 55.56% | | | | | | | | | |
| 69 | 468 | 1059 | 44.19% | | | | | | | | | |
| 73 | 387 | 700 | 55.29% | | | | | | | | | |
| 76 | 933 | 1059 | 88.10% | 1397 | 3500 | 39.91% | 348.705 | 1504.05 | 23.18% | 659.033 | 1471 | 44.80% |
| 90 | 2366 | 2289 | 103.36% | 3597 | 3500 | 102.77% | 3049.37 | 3325.14 | 91.71% | 2584.41 | 3428 | 75.39% |
| 91 | 1677 | 2600 | 64.50% | 0 | 2600 | 0.00% | | | | | | |
| 110 | 1064 | 3103 | 34.29% | 678 | 3500 | 19.37% | 200.685 | 3776.85 | 5.31% | 164.433 | 3386.49 | 4.86% |
| 117 | 911 | 2634 | 34.59% | 1343 | 3050 | 44.03% | 1164.53 | 3127.05 | 37.24% | 1659.83 | 3053 | 54.37% |
| 118 | 456 | 596 | 76.51% | 494 | 1050 | 47.05% | 434.645 | 1120.05 | 38.81% | 269.565 | 1097 | 24.57% |
| Average | | | 71.39% | | | 44.23% | | | 40.76% | | | 44.74% |

Source: EC Commission.

Note: 1991 and 1992 data concern Czechoslovakia; 1993 and 1994 data, the Czech Republic only.

(1) 1 Jan 1991 to 31 Mar 1992.

(2) 1 Jan 1992 to 31 Mar 1993. OETH finds almost always slightly higher utilization rates.

(3) "Working level"

Table 4.

Outward Processing Traffic
Quota

| MFA | Unit | 1992(1) | 1993(2) | 1994 | 1995(3) | 1996(3) | 1997(3) | Growth | Growth(4) |
|----------------|---------|---------|---------|--------|---------|---------|---------|--------|-----------|
| 4 | 1000pcs | 3500 | 4800 | 5088 | 5904 | 6259 | 6634 | 38% | 26% |
| 5 | 1000pcs | 2300 | 3705 | 3927 | 4609 | 4886 | 5179 | 40% | 26% |
| 6 | 1000pcs | 5500 | 3770 | 3996 | 5443 | 5770 | 6116 | 62% | 26% |
| 7 | 1000pcs | 3000 | 2400 | 2544 | 2963 | 3141 | 3330 | 39% | 26% |
| 8 | 1000pcs | 4500 | 3965 | 4143.5 | 4943 | 5165 | 5397 | 36% | 19% |
| 12 | 1000prs | 6000 | 6240 | 6708 | 8235 | 8852 | 9516 | 53% | 34% |
| 15 | 1000pcs | 3500 | 2025 | 2177 | 2587 | 2781 | 2989 | 48% | 34% |
| 16 | 1000pcs | 1000 | 900 | 967.5 | 1470 | 1580 | 1699 | 89% | 34% |
| 17 | 1000pcs | 1200 | 720 | 785 | 944 | 1029 | 1121 | 56% | 41% |
| 24 | 1000pcs | 2000 | 875 | 941 | 1107 | 1190 | 1279 | 46% | 34% |
| 26 | 1000pcs | 1800 | 1350 | 1451 | 1708 | 1836 | 1974 | 46% | 34% |
| 76 | t | 6000 | 2800 | 3052 | 4020 | 4381 | 4776 | 71% | 41% |
| Average growth | | | | | | | | 52% | 31% |

(1) aggregate EC level - in L45 1992; Czechoslovakia.

(2) in L123 1994 (New Additional Protocole); Czech Republic only

(3) For 95, 96, 97: in L94 1995 (renegotiated)

(4) without taking into account the revision due to NAFTA membership

Table 5. OPT quota

Quota share
In tons

| MFA | 1992 | % | 1993 | % | 1994 | % | 1995 | % | 1996 | % | 1997 | % |
|-----|-------|-------|-------|------|-------|------|-------|------|-------|------|-------|------|
| 4 | 540 | 2.80% | 741 | 6% | 785 | 6% | 911 | 5% | 966 | 5% | 1024 | 5% |
| 5 | 508 | 3% | 818 | 6% | 867 | 3% | 1017 | 6% | 1079 | 6% | 1143 | 6% |
| 6 | 3125 | 16% | 2142 | 17% | 2270 | 8% | 3093 | 18% | 3278 | 18% | 3475 | 17% |
| 7 | 541 | 3% | 432 | 3% | 458 | 2% | 534 | 3% | 566 | 3% | 600 | 3% |
| 8 | 978 | 5% | 862 | 7% | 901 | 3% | 1075 | 6% | 1123 | 6% | 1173 | 6% |
| 12 | 247 | 1% | 257 | 2% | 276 | 1% | 339 | 2% | 364 | 2% | 392 | 2% |
| 15 | 4167 | 22% | 2411 | 19% | 2592 | 9% | 3080 | 18% | 3311 | 18% | 3558 | 18% |
| 16 | 1250 | 6% | 1125 | 9% | 1209 | 4% | 1838 | 11% | 1975 | 11% | 2124 | 11% |
| 17 | 839 | 4% | 503 | 4% | 549 | 2% | 660 | 4% | 720 | 4% | 784 | 4% |
| 24 | 513 | 3% | 224 | 2% | 241 | 1% | 284 | 2% | 305 | 2% | 328 | 2% |
| 26 | 581 | 3% | 435 | 3% | 468 | 2% | 551 | 3% | 592 | 3% | 637 | 3% |
| 76 | 6000 | 31% | 2800 | 22% | 3052 | 11% | 4020 | 23% | 4381 | 23% | 4776 | 24% |
| Sum | 19288 | 100% | 12751 | 100% | 13669 | 100% | 17401 | 100% | 18660 | 100% | 20014 | 100% |

Note: renegotiated for 1995, 96, 97.

1992: for Czechoslovakia, then the Czech Republic only.

Table 6.

OPT Quota Utilisation Rate

| MFA (1) | 1992 | | | 1993 | | | 1994 | | |
|----------|------------|----------|-----|------------|----------|------|------------|----------|------|
| | license(2) | quota(3) | QUR | license(4) | quota(5) | QUR | license(4) | quota(5) | QUR |
| 4 (pcs) | 880 | 3500 | 25% | 6648 | 4800 | 139% | 6360 | 5088 | 125% |
| 5 (pcs) | 2072 | 2300 | 90% | 3162.014 | 3705 | 85% | 4872.143 | 3927 | 124% |
| 6 (pcs) | 2397 | 5500 | 44% | 4979.259 | 3770 | 132% | 5241.673 | 3996 | 131% |
| 7 (pcs) | 718 | 3000 | 24% | 2997.254 | 2400 | 125% | 3260.947 | 2544 | 128% |
| 8 (pcs) | 953 | 4500 | 21% | 2000.451 | 3965 | 50% | 2545.33 | 4143.5 | 61% |
| 12 (prs) | 3320 | 6000 | 55% | 8642.4 | 6240 | 139% | 9725.8 | 6708 | 145% |
| 15 (pcs) | 1207 | 3500 | 34% | 1989.381 | 2025 | 98% | 2414.323 | 2177 | 111% |
| 16 (pcs) | 176 | 1000 | 18% | 437.371 | 900 | 49% | 398.117 | 967.5 | 41% |
| 17 (pcs) | 728 | 1200 | 61% | 997.2 | 720 | 139% | 981.25 | 785 | 125% |
| 24 (pcs) | 685 | 2000 | 34% | 1211.875 | 875 | 139% | 127.035 | 941 | 14% |
| 26 (pes) | 338 | 1800 | 19% | 1491.545 | 1350 | 110% | 1972.812 | 1451 | 136% |
| 76 (t) | 2098 | 6000 | 35% | 2403.728 | 2800 | 86% | 2758.735 | 3052 | 90% |
| AQUR | | | 38% | | | 107% | | | 103% |

Note: 1992 data concern Czechoslovakia; 1993 and 1994 data, the Czech Republic only.

Sources: (2) OETH (3) OJ L 45, 1992 (4) EC Commission (5) OJ L123, 1994.

Table 7.

OPTquota in proportion of total quota (direct + OPT), and growth.

| MFA | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1993-94 | 1994-97 | 1993-97 |
|-------|------|------|------|------|------|------|---------|---------|---------|
| 4 | 43% | 45% | 45% | 42% | 43% | 43% | 1% | -5% | -4% |
| 5 | 33% | 53% | 54% | 52% | 52% | 53% | 1% | -2% | -1% |
| 6 | 61% | 60% | 61% | 56% | 56% | 57% | 1% | -7% | -6% |
| 7 | 65% | 68% | 68% | 63% | 63% | 64% | 1% | -6% | -6% |
| 8 | 43% | 47% | 48% | 47% | 47% | 48% | 1% | 0% | 0% |
| 12 | 21% | 34% | 24% | 30% | 31% | 31% | -31% | 32% | -9% |
| 15 | 73% | 76% | 77% | 71% | 71% | 72% | 1% | -6% | -6% |
| 16 | 42% | 47% | 48% | 46% | 46% | 47% | 1% | -3% | -2% |
| 17 | 51% | 69% | 70% | 61% | 62% | 63% | 1% | -10% | -10% |
| 24 | 31% | 36% | 37% | 28% | 28% | 29% | 2% | -21% | -20% |
| 26 | 53% | 57% | 58% | 47% | 48% | 49% | 1% | -16% | -15% |
| 76 | 63% | 67% | 67% | 62% | 63% | 63% | 1% | -6% | -5% |
| Aver. | 48% | 55% | 55% | 50% | 51% | 51% | -2% | -4% | -7% |

Note: 1995-97 data are renegotiated

Table 8. Growth of OPT and direct quota (expressed in t).

| MFA | direct | opt | direct | opt | direct | opt | direct | opt | direct | opt | direct | opt |
|---------|--------|-----|--------|-----|--------|-----|--------|-----|--------|-----|--------|-----|
| 4 | 4% | 6% | 31% | 16% | 4% | 6% | 4% | 6% | 47% | 38% | 17% | 26% |
| 5 | 4% | 6% | 27% | 17% | 4% | 6% | 4% | 6% | 43% | 40% | 17% | 26% |
| 6 | 4% | 6% | 68% | 36% | 4% | 6% | 4% | 6% | 89% | 62% | 17% | 26% |
| 7 | 4% | 6% | 47% | 16% | 4% | 6% | 4% | 6% | 65% | 39% | 17% | 26% |
| 8 | 3% | 5% | 24% | 19% | 3% | 4% | 3% | 4% | 35% | 36% | 13% | 19% |
| 12 | 5% | 8% | 51% | 23% | 5% | 7% | 5% | 8% | 74% | 53% | 22% | 34% |
| 15 | 5% | 8% | 62% | 19% | 5% | 7% | 5% | 7% | 87% | 48% | 22% | 34% |
| 16 | 5% | 8% | 68% | 52% | 5% | 7% | 6% | 8% | 95% | 89% | 22% | 34% |
| 17 | 6% | 9% | 76% | 20% | 6% | 9% | 6% | 9% | 109% | 56% | 26% | 41% |
| 24 | 5% | 8% | 76% | 18% | 5% | 7% | 5% | 7% | 103% | 46% | 22% | 34% |
| 26 | 5% | 7% | 80% | 18% | 5% | 7% | 5% | 8% | 108% | 46% | 22% | 34% |
| 76 | 6% | 9% | 67% | 32% | 6% | 9% | 6% | 9% | 99% | 71% | 26% | 41% |
| Average | 5% | 7% | 56% | 24% | 5% | 7% | 5% | 7% | 80% | 52% | 20% | 31% |

1991 and 1992: for Czechoslovakia, then for the Czech Republic only.

(*) without taking into account the revision due to EFTA membership

III/ Outward Processing Traffic as a vehicle for the deployment of production activity to Central Europe

Whereas the first part identified the different types of constraint and opportunity potentially bearing upon the formation of OPT networks in CEECs, the present one accounts for the actual patterns of OPT relations. It proposes to 'map' the OPT partnerships that developed between firms of the two area, and, on this basis, to assess the influence of the framework within which the latter take their strategic decisions. In other terms, which opportunities are cogent incentives, and which constraint is truly compelling? How effective are market, institutional and political determinants in shaping patterns of OPT between the EU and CEECs?

Overall, the present part aims at gauging the nature of the contribution of OPT to the pattern of economic interdependence between the EU and CEECs. The fundamental question, in this respect, has to do with the rationale underlying Western firms strategies: do the latter aim at reaping the advantages of wage differentials on a short term basis, or are they ready to enter into more demanding and equal partnerships with local firms? It is easy to see how far-reaching the implications of such an issue are in terms of local and regional development. Indeed, in certain sectors, and in certain host countries, OPT has become a major (if not the main) vehicle for interdependence between the EU and CEECs. Thus, in the face of the sometimes very high degree of dependence developed by CEECs' foreign trade upon such 'temporary' trade, it is crucial to identify the 'trajectories' that OPT networks are most likely to follow. These latter are nothing but one factor contributing to the definition of the terms under which the dynamics of regional integration develops.

An important finding made explicit by Part II is that no general consideration can be made about the above issues. Looking at the possible trajectories of EU firms' deployment strategies, it shows that it is actually firm-specific variables which make sense of the general OPT determinants addressed in Part I.

Chapter 3. Contribution of OPT to the regional division of labour: empirical evidence

The present Chapter aims at a preliminary assessment of the role of OPT in the formation of a unified regional economy. It starts by quantitatively 'mapping' OPT relations between the EU countries and the CEECs and thus highlights two striking features: first, the general importance of OPT in total CEECs trade and the particularly high levels of OPT in certain sectors; second, the fact that, from whatever standpoint, OPT in CEECs is a very German story. Not only are German firms by far the main source of EU OPT in the CEECs, but also, in certain sectors, their OPT activities account for quite large shares of host countries' total trade to the EU.

In the face of the quantitative importance of OPT in the overall EU-CEECs relations, the question of the prospects of OPT partnerships is of crucial relevance for the terms under which economic interdependence between the EU and CEECs takes place.

As a matter of fact, looking at firm-level shows how ambiguous the benefits of this type of economic transactions can be for local firms. True, OPT proved to be an almost providential solution to many CEECs firms in the aftermath of the demise of the CMEA in 1991. However, a serious pitfall characterising OPT is the loss of control of local firms over the two extremes of the production chain; the resulting deprivation from market power makes it quite difficult for the latter to take over autonomous production after the hypothetical ending of an OPT contract. This is particularly worrying if account is taken of likely wage increases in the CEECs risking to translate into foreign partners' withdrawal.

Overall, what is at stake in the future developments of OPT partnerships is the survival of local firms, and beyond, the terms (the price) of economic interdependence.

3. 1 A statistical appraisal of OPT relations between the EU and CEECs

1. General aggregate features of OPT between the EU12 and the CEEC4

Absolute levels, proportion in total trade and evolution

OPT is not entirely a new phenomena to be connected to the opening up of the CEECs markets. As a matter of fact, starting levels of OPT in the then Centrally Planned Economies were already non negligible in 1991. At that date, more than 18% of Hungary's exports to the

EU12 was actually ascribable to OPT (the highest proportion registered across the region).⁹⁹ In absolute terms, it is Poland which was the privileged OPT partner of the EU12 (OPT transactions amounted to ECU 0.8 bn in 1991, representing 13.5% of total Polish exports to the EU12). The former Czechoslovakia was characterised by the lowest starting point with a total amount of OPT exports to the EU 2.5 times lower than that of Poland (ECU 0.3 bn, i.e., 8% of its total exports to the EU12).

Table 1. Exports after Outward Processing to the EU12 (1000 ECU), and proportion in total exports to the EU12 (%)

| | 1991 | | 1992 | | 1993 | | 1994 | | 1995 | | 1991-1995 | |
|---------|--------|--------|---------|--------|---------|--------|---------|--------|---------|--------|-----------|---------|
| | opt | % | opt | % | opt | % | opt | % | opt | % | opt | % |
| CS (1) | 332413 | 8.18% | 595352 | 10.74% | 757571 | 12.62% | 1022288 | 12.40% | 1163720 | 11.11% | +250.08% | +33.73% |
| Hungary | 669282 | 18.47% | 805077 | 20.19% | 800266 | 20.23% | 861971 | 17.51% | 882079 | 13.98% | +31.79% | -26.43% |
| Poland | 838820 | 13.50% | 1122730 | 15.86% | 1407030 | 18.56% | 1685518 | 18.51% | 1836823 | 16.54% | +118.98% | +22.49% |

(1) Czechoslovakia in 1991, 1992, the Czech Republic and Slovakia in 1993, 1994, and 1995.

Overall, total OPT transactions¹⁰⁰ between the EU12 and the CEECs increased by 111% between 91 and 95 (from ECU 1.8 bn to ECU approximately ECU 4 bn in 1995, i.e., around 14% of total trade between the 2 area over the considered period). What is remarkable is how OPT activities increased since 1991 in Poland and in the former Czechoslovakia. The low starting points of OPT proportion characterising the two countries account for strong catching up effects: OPT exports to the EU12 grew by 250% and 119% respectively between 1991 and 1995. In the meantime, Hungary increased its OPT exports to the EU12 by only 32%.

Interestingly enough, however, there are two phases in the 1991-1995 period. Until 1993, CEECs OPT clearly follows an increasing trend, with the fastest growth rates of OPT registered between 1991 and 1992. But whereas absolute levels continue to increase, OPT dependence starts to decrease in the 3 countries as of 1993 (faster in Hungary than in the two other CEECs). As a matter of fact, in 1993 around 20% of the total trade of Hungary and Poland is dependent on OPT, and slightly less than 13% of that of the former Czechoslovakia; but in 1995 the proportions fall to 17% in Poland (which became in 1994 the CEEC most dependent on OPT before Hungary), 14% in Hungary, and 11% in the former Czechoslovakia.

⁹⁹ The source of all the statistical data contained in the present session is EUROSTAT COMEXT database.

¹⁰⁰ It is chosen, in the present Chapter, to look at *re-exports* after processing (from the CEECs viewpoint) as they arguably reflect the OPT phenomenon more accurately (imports risk indeed to be diverted from their supposed use and sold locally, for example; what is more, re-exports into the EU are likely to be monitored more carefully in the fear that they might be in contravention with trade measures enforced by the Community ...). Hence, in the following, 'OPT trade' actually goes for 'OPT re-exports into the EU'.

Table 2. Growth of OPT proportion in total exports from the CEEC4 to the EU12, 1991-1995 (%).

| | 1991-92 | 1992-93 | 1993-94 | 1994-95 | 1991-1995 |
|---------|---------|---------|---------|---------|-----------|
| CS (1) | +31.25% | +17.46% | -1.70% | -10.44% | +35.73% |
| Hungary | +9.34% | +0.29% | -13.52% | -22.44% | -26.45% |
| Poland | +17.42% | +17.05% | -0.30% | -10.61% | +22.49% |

(1) Czechoslovakia in 1991, 1992, the Czech Republic and Slovakia in 1993, 1994, and 1995.

Thus, Hungary succeeds in reducing its OPT dependence by 26% between 1991 and 1995, and registers at the end of the period the lowest absolute level (ECU 900 M). Instead, in the former Czechoslovakia and in Poland, where OPT dependence increased over the same period (+36% and +22%, respectively), absolute levels were brought to ECU 1.2 and 1.8 bn, respectively. As a result, Poland is, in 1995, the main provider of OPT goods to the EU12 and it is the country most dependent on OPT for its foreign trade.

Contribution of OPT to the evolution of total trade

The contribution of OPT to the general trade performance of the CEECs is far from negligible. Re-exports indeed explain 14% of CEECs' exports growth to the EU12 between 1991 and 1995.¹⁰¹ The dynamism of OPT trade between Poland and Czechoslovakia, on the one hand, and the EU12 on the other hand had a significant impact on the growth of total exports (defined as the sum of OPT exports and "direct" exports).

Table 3. Direct and total exports from the CEEC4 to the EU12 (1000 ECU)

| | 1991-92 | | 1992-93 | | 1993-94 | | 1994-95 | | 1991-1995 | |
|---------|---------|---------|---------|--------|---------|---------|---------|---------|-----------|----------|
| | direct | total | direct | total | direct | total | direct | total | direct | total |
| CS (1) | +32.66% | +36.46% | +6.05% | +8.33% | +37.61% | +37.27% | +28.98% | +27.10% | +149.72% | +157.93% |
| Hungary | +7.69% | +10.02% | -0.96% | -0.89% | +28.83% | +25.55% | +38.23% | +31.94% | +89.93% | +79.20% |
| Poland | +10.89% | +13.99% | +3.62% | +7.07% | +20.23% | +20.15% | +24.85% | +21.91% | +72.49% | +78.77% |

(1) Czechoslovakia in 1991, 1992, the Czech Republic and Slovakia in 1993, 1994, and 1995.

¹⁰¹ See footnotes 107 and 108 for the underlying computation.

Between 1991 and 1995, OPT exports inflate the growth rate of total exports by around 5% in the former Czechoslovakia, and by around 10% in Poland. (+158% increase of total trade, but "only" +150% without OPT for the Czech trade. For Poland: +79% with OPT, and +72% without). If the same computation is done on the period between 1991 and 1993, i.e., that of major OPT dynamism, the OPT contribution appears to be even stronger: the Polish growth rate, for example, was inflated by more than 48% as a result of OPT trade, and that of the former Czechoslovakia by +18%. But as of 1993, OPT growth turns out to be systematically lower than that of direct trade. Total trade performances are consequently slightly eroded when account is taken of OPT.

In the case of Hungary, the same distinction between the pre- and the post-1993 periods holds. The difference is that due to a stronger deceleration since 1993, OPT has actually reduced the growth rate of total trade not only between 1993 and 1995, but also on the whole 1991-1995 period. As a result, direct trade increased by 90%, OPT by 32% and total trade by less than 80%.

Overall, OPT growth explains 20% of total exports growth from Poland to the EU12 between 1991 and 1995, 13% and 7% of total exports growth from the former Czechoslovakia and Hungary, respectively.

• In sum ...

-Poland is in 1995 the main host country for EU OPT operations, in absolute terms, and in proportion of total trade (17%)

-with the highest starting levels of OPT proportions in total trade (18% in 1991), Hungary is the only country characterised by a decrease of OPT dependence between 1991 and 1995

-the 3 countries are characterised by a decrease of OPT proportion as of 1993

Main geographical patterns, and evolution

The bulk of OPT trade in CEECs is undertaken by Germany: 74% of EU OPT in the CEECs is of German origin. Indeed, German OPT in the CEECs amounts to ECU 2.9 bn, whereas the Netherlands, which is the second biggest source of OPT engage no more than ECU 280 M. Italy, France and Denmark follow with comparable levels (ECU 214 M, 191 M, and 170 M respectively). Finally, a last category consists of countries marginally and anecdotally involved in OPT operations (Belgium, the UK ... are countries registering barely more than ECU 50 M of OPT in CEECs in 1995).

Table 4. OPT to CEECs by member states (1000 ECU), growth (%) and proportion in total OPT from the EU to CEECs (%).

| | 1991 | 1995 | 1991-1995 | % in 1991 | % in 1995 |
|----------|---------|---------|-----------|-----------|-----------|
| France | 205310 | 190781 | -7% | 6.59% | 4.91% |
| Belg Lux | 68338 | 56043 | -18% | 2.19% | 1.44% |
| NL | 251061 | 277111 | +10% | 8.06% | 7.14% |
| Germ | 2323476 | 2900763 | +25% | 74.58% | 74.71% |
| It | 76353 | 214268 | +181% | 2.45% | 5.52% |
| UK | 53945 | 59989 | +11% | 1.73% | 1.55% |
| Irl | 212 | 0 | -100% | 0.01% | 0% |
| DK | 136323 | 172115 | +26% | 4.38% | 4.43% |
| Greece | 0 | 21 | - | 0% | 0% |
| Port | 6 | 416 | +6833% | 0% | 0.01% |
| Spain | 448 | 1049 | +134% | 0.01% | 0.03% |
| EU12 | 3115472 | 3882622 | +25% | 100% | 100% |

A remarkable feature concerning German OPT activities in CEECs is that they increased at the very respectable rate of 25% between 1991 and 1995. Two other countries registering significant increases of OPT are Denmark (+26%), and most notably Italy (+181%); on the face of it, the Netherlands follow only a modest increasing trend (+10%). As to France, it is conspicuous for registering one of the rare decreasing trend (-7% over the same period). Overall, following the unchallenged German supremacy the Netherlands preserve their second position (7%), but closely behind, the Italians are rapidly increasing their presence (6% as against 2% in 1991).

In general terms, around half of EU OPT is geared to Poland (47% to be precise), whereas both the Czech Republic and Hungary account for 23% of EU OPT to the CEECs; in last position, Slovakia attracts 7% of EU OPT. On this basis, it is interesting to identify privileged relationships between host and home countries, as there are indeed strong geographical proclivities.

Germany is mainly geared to Poland (Poland represents 46% of German OPT in the CEEC4, i.e., ECU 1.3 bn). The second main destination of German OPT activities is the Czech Republic (29%). Interestingly enough, the growing German interest in OPT partnerships with Czech firms is at the expense of Germano-Hungarian relations (19% of German OPT in the CEECs).

Dutch firms favour OPT activities in Poland in particular mode (62% of total Dutch OPT to the CEECs, i.e., ECU 176 M), as well as French firms (43% of French OPT in the CEEC4,

i.e., ECU 82 M). However, French firms also gear an important proportion of their OPT activities to Hungary (36%).

On the face of it, Italian firms are comparatively more prone to undertake OPT with Hungarian partners. Indeed Hungary represents no less than 64% of the Italian OPT activities in the CEEC4. In a way, the strong Italian attraction for Hungary substitutes for the diminishing German interest.

Figure 1. Bilateral OPT flows in ECU, % of bilateral total trade, and % of OPT trade, in 1995.

| 1995 | Germany | Netherlands | Italy | France | EU12 |
|------------|--|--|---|--|---|
| Poland | 1.3bn; 21 % total trade - 46% Germany-CEECs -73% Poland-EU | 176M; 24 % total trade - 62% NI-CEECs -10% Poland-EU | 32M; 3 % total trade -15% Italy-CEECs -2% Poland-EU | 82M; 11 % total trade -43% France-CEECs -4% Poland-EU | 1.8bn; 17 % total trade -47% EU-CEEC |
| Hungary | 550M; 15 % total trade -19% Germany-CEECs - 62% Hungary-EU | 65M; 21% total trade -23% NI-CEECs -7% Hungary-EU | 137M; 14 % total trade -64% Italy-CEECs -16% Hungary-EU | 68M; 16% total trade -36% France-CEECs -8% Hungary-EU | 880M; 14 % total trade -23% EU-CEECs |
| Czech Rep. | 840M; 15 % total trade -29% Germany-CEECs -93% CR-EU | 13M; 5% total trade -5% NI-CEECs -2% CR-EU | 17M; 3% total trade -8% Italy-CEECs -2% CR-EU | 21M; 6% total trade -11% France-CEECs -2% CR-EU | 900M; 11 % total trade -23% EU-CEECs |
| Slovakia | 170M; 10% total trade - 6% Germany-CEECs - 65% Slovakia-EU | 30M; 26% total trade -11% NI-CEECs -11% Slovakia-EU | 28M; 7% total trade -13% Italy-CEECs -11% Slovakia-EU | 20M; 13% total trade -10% France-CEECs -7% Slovakia-EU | 263M; 10 % total trade -7% of EU-CEECs |
| CEEC4 | 2.9bn; 75% EU OPT -17% total trade | 280M ; 7% EU OPT -20% total trade | 214M; 6% EU OPT -7% total trade | 191M; 5% EU OPT -11% total trade | |

From the viewpoint of the host countries, additional predilection and idiosyncrasy appear. It is no surprise that all the CEECs are strongly oriented towards Germany. But there are some differences of magnitude.

It is the Czech Republic which is most dependent on the German presence: the share of Germany is the highest (and increasing), accounting for 93% of total Czech OPT exports to the EU12. Interestingly enough, the Czech Republic comes in general only 3rd in the most preferred destination of EU OPT; only in the case of Germany does the country rank in second position.

Instead, Poland partners tend to be (relatively) more diversified. Whereas the German share is about 20 points lower than in the case of the Czech Republic (73% of total Polish OPT to the EU12), the Netherlands account for a non negligible proportion of total EU OPT in Poland (10%).

As to the special relation between Hungary and Italy, it is relativised from the Hungarian viewpoint: indeed the Italian share of Hungarian OPT in the EU is one of the highest among non-

German partnerships (16%), but it still compares with the German one, which, even reduced, is nevertheless 62%.

The above features show how uneven the distribution of OPT activities in Central Europe can be with some bilateral relations strongly privileged.

Quantitatively, the most important bilateral flows always concern Germany on the one hand and each CEEC on the other hand. Naturally, it is the German-Polish OPT partnerships which are the most frequent. Overall, they account for an aggregate figure of ECU 1.3 bn, i.e., 21% of the total exports of Poland to Germany. Then come the Germano-Czech relations (ECU 840 M), the Germano-Hungarian ones (550 M), and the Germano-Slovak partnerships (170 M).

The most important bilateral relations which do not involve partners of German origin are those between Dutch and Polish firms (ECU 176 M), and between Italian and Hungarian firms (137 M).

Finally, a last category of OPT bilateral relations gives rise to much lower aggregate levels of transactions: the Franco-Polish and the Franco-Hungarian partnerships, the Dutch-Hungarian relations, and to an lower extent the Italo-Polish ones (ECU 82 M, 68 M, 60 M, and 32 M, respectively).

• In sum, the following points are of particular relevance:

- the bulk of OPT trade in CEECs is undertaken by German firms: 74% of EU OPT in the CEECs is of German origin (ECU 2.9 bn)
- the Netherlands is the 2nd biggest source of OPT (ECU 280 M). Italy, France and Denmark follow (around ECU 200 M).
- Italian OPT in the CEEC4 registered a remarkable growth rate of more than 143%, whereas France is conspicuous for registering one of the rare decreasing trend
- half of EU OPT is geared to Poland, which is the privileged destination of German, Dutch, and to a lower extent of French firms. Notably, Italian firms are primarily oriented to Hungary.
- the Czech Republic is the country that registers the highest proportion of OPT of German origin (93%!), but the country occupies only a secondary position in the OPT activities of Western European firms, except in the electrical machinery sector.

Main product patterns, and evolution

An analysis of the product structure of OPT transactions between the EU12 and CEECs shows a marked stability; indeed, the first 10 positions (accounting for more than 95% of the total OPT transactions between the EU and CEECs) are occupied by the same sectors in 1991 and in 1995.

Table 5. Ranking of the 10 first positions of OPT between the EU12 and CEEC4 in 1991 and 1995; Absolute levels (M ECU) and proportion in total trade (%).

| 1991 | | | 1995 | | |
|----------------|--------|-----|----------------|--------|-----|
| | Abs. | % | | Abs. | % |
| 1. t&c | 1200 M | 62% | 1. t&c | 2600 M | 71% |
| 2. footwear | 153 M | 48% | 2. elec. mach. | 409 M | 16% |
| 3. elec. mach. | 114 M | 21% | 3. furniture | 170 M | 11% |
| 4. mech. mach. | 106 M | 12% | 4. footwear | 144 M | 28% |
| 5. furniture | 87 M | 16% | 5. mech. mach. | 131 M | 5% |
| 6. cars | 43 M | 9% | 6. cars | 59 M | 3% |
| 7. leathers | 36 M | 18% | 7. plastic | 47 M | 4% |
| 8. edible | 24 M | 6% | 8. leathers | 38 M | 13% |
| 9. I&S | 16 M | 1% | 9. edible | 36 M | 10% |
| 10. plastic | 13 M | 2% | 10. I&S | 33 M | 1% |
| total | 1800 M | 13% | total | 3800 M | 14% |

The Textile and Clothing sector comes unsurprisingly first both in 1991 and 1995, with an overwhelming and slightly increasing share of total OPT relations between the two area (from 64% to 68% between 1991 and 1995).

The following positions underwent some interesting changes. Most notably, the footwear and the mechanical machinery were downgraded in the ranking. The trend is of particular relevance in the case of footwear: not only the sector's rank fell from the second position in 1991 (8% of total EU-CEECs relations) to the 4th in 1995 (less than 4%), but also OPT in the sector underwent a decrease of absolute levels of transactions (ECU 144 M in 1995 as against ECU 153 M in 1991). As to the mechanical machinery, from 6% of total EU-CEECs OPT in 1991 (i.e., a 4th position), it represented hardly more than 3% of the very same exchanges in 1995. But in contrast to the footwear case, and however modest, increasing trends characterised OPT in the sector (+23% between 1991 and 1995).

On the face of it, the electrical machinery followed extremely dynamic trends, registering a growth rate among the strongest (+258% between 1991 and 1995) with a resulting shift from the 3rd to the second position right after T&C (i.e., with ECU 410 M, more than 10% of total EU-CEECs OPT). Another very dynamic sector is the plastics industry (+278% between 1991 and 1995); however absolute levels remained marginal (ECU 47 M, i.e., slightly more than 1% of ECU-CEECs OPT relations). As a result, in 1995, the plastic industry occupies the 7th position among the sector most concerned by OPT relations.

Furniture is the other sector which together with the electrical machinery substituted for the downgrading position of the footwear and the mechanical machinery sectors; OPT in the sector underwent an increase of 95% between 1991 and 1995 (from ECU 87 M to 170 M). However, the share in total EU-CEECs OPT remained stable at 5%.

The other sectors most concerned are the automotive industry (characterised by a modest growth of 37% between 1991 and 1995), leathers, edible preparations, and to quite a lower extent iron and steel. All of them lost one position in the graduatory (with respective ranking of 6th, 8th, 9th and 10th in 1995).

More marginal but almost systematically characterising the product structure of member states are the optical, the toy, and the clock sectors; as well as printing and glassware. It is worth noting the very strong growths that often characterised OPT in these sectors. In the base metal sector, for example, OPT increased by 571% between 1991 and 1995.

At this level of aggregation, it is possible to distinguish between different categories of sectors according to the type of evolutions undergone by OPT absolute levels and proportions in total trade. One first category concerns sectors experiencing strong OPT increases with non negligible absolute starting levels: the electrical machinery, and the T&C sectors. By contrast, plastics is a sector displaying sharp growth rates of OPT absolute levels as well as OPT proportions in total trade while being relatively new in the business. What is more, further distinction is to be made between sectors experiencing decreasing trends of OPT proportions (almost all except T&C, edible preparation and, as mentioned above, plastics), while characterised by increasing absolute levels and, the mechanical machinery in which not only OPT share in total trade but also OPT absolute levels decrease.

•In sum, the main features characterising the product structure of the EU-CEECs OPT exchanges are the following:

- T&C represents the bulk of OPT transactions
- T&C is nearly the only sector characterised by a simultaneous growth of absolute levels and a continuing increase of OPT proportion in total trade; the other one, the plastic industry, accounts for incomparably lower absolute levels of OPT transactions

-despite decreasing OPT proportions, the sectors of electrical machinery and furniture are characterised by dynamic absolute growths

-OPT growth in the sector of mechanical machinery is increasingly lower than that of direct trade. With lower levels of transactions, the automotive industry is characterised by a similar trend

-there is a marked disaffection of EU operators for OPT in the footwear sector translating into absolute decreases.

2. Sector- and country-specific features of OPT between the EU12 and the CEEC4

General cross-sectoral and cross-national features of OPT in the CEECs need to be qualified by sometimes strong specific traits.

Absolute levels in 1995

From the viewpoint of home countries

There are, from the viewpoint of home countries, different country-specific features concerning the commodity structure of their OPT relations.

In first place, the quantitative disparity between Germany and the other EU countries is, of course, to be stressed. The very bulk of EU OPT is often almost exclusively attributable to the activities of German firms. In T&C, for example, Germany undertakes 10 times more OPT than the others EU members (ECU 1.8 bn as against a range going from ECU 140 M in Italy to ECU 280 M in the Netherlands). The German unmitigated domination is equally affirmed in both the sectors of electrical and mechanical machineries: 80% for electrical machinery, and more than 90% of EU OPT in CEECs for mechanical machinery (ECU 360 M, and 100 M, respectively). It is also the case in the sectors of furniture and edible preparations (ECU 160M, and 30M, respectively).¹⁰²

¹⁰² The list of the sectors where Germany is almost the only source of OPT is actually long ... it comprises miscellaneous manufactures, the printing industry (ECU 21 and 14 M, respectively in 1995 in CEECs) and also base metals, glassware, perfumery...

Tables 6. OPT re-imports from the CEEC4 (1000 ECU), proportion in total OPT from the CEEC4, and proportion in total OPT from the CEEC4 to the EU12.

| Germany | | | | Italy | | | | Netherlands | | | |
|----------|---------|------|------|----------|--------|------|-----|-------------|--------|------|-----|
| | OPT | % | EU% | | OPT | % | EU% | | OPT | % | EU% |
| TT | 2900763 | 100% | 75% | TT | 214268 | 100% | 6% | TT | 277111 | 100% | 7% |
| t&c | 1838793 | 63% | 70% | t&c | 143403 | 67% | 5% | t&c | 249493 | 90% | 9% |
| elec. | 361336 | 12% | 88% | shoes | 30418 | 14% | 21% | elec. | 15480 | 6% | 4% |
| furn. | 163073 | 6% | 96% | plast | 16649 | 8% | 35% | | | | |
| mech. | 122164 | 4% | 93% | mech. | 5147 | 2% | 4% | | | | |
| shoes | 96138 | 3% | 67% | elec. | 4066 | 2% | 1% | | | | |
| cars | 51314 | 2% | 87% | cars | 2578 | 1% | 4% | | | | |
| edib | 32584 | 1% | 91% | pharm. | 2137 | 1% | 77% | | | | |
| leathers | 29367 | 1% | 77% | railways | 1644 | 1% | 19% | | | | |
| optic. | 28373 | 1% | 91% | | | | | | | | |
| plast | 27937 | 1% | 59% | | | | | | | | |
| I&S | 27907 | 1% | 85% | | | | | | | | |
| misc. | 21148 | 1% | 100% | | | | | | | | |
| print. | 13872 | 0.5% | 100% | | | | | | | | |
| basemers | 13556 | 0.5% | 97% | | | | | | | | |
| toys | 12268 | 0.5% | 85% | | | | | | | | |
| glassw | 8750 | 0.5% | 95% | | | | | | | | |
| clock | 7483 | 0.5% | 88% | | | | | | | | |

| DK | | | | Belg-Lux | | | |
|-------|--------|------|-----|----------|-------|------|-----|
| | OPT | % | EU% | | OPT | % | EU% |
| TT | 170811 | 100% | 4% | TT | 56043 | 100% | 1% |
| t&c | 154696 | 91% | 6% | t&c | 36295 | 65% | 1% |
| shoes | 10397 | 6% | 7% | elec | 15531 | 28% | 4% |

| France | | | | UK | | | |
|----------|--------|------|-----|-----|-------|------|-----|
| | OPT | % | EU% | | OPT | % | EU% |
| TT | 190781 | 100% | 5% | TT | 59989 | 100% | 2% |
| t&c | 158894 | 83% | 6% | t&c | 59357 | 99% | 2% |
| elec. | 11360 | 6% | 3% | | | | |
| shoes | 4325 | 2% | 3% | | | | |
| leathers | 3516 | 2% | 9% | | | | |
| cars | 3438 | 2% | 6% | | | | |

Yet, whenever the Germans have a weaker grip on the OPT business in CEECs, it is the Italians who fill the gap. For example, Italy is characterised by 'somewhat'¹⁰³ dominant positions in the sector of plastics (35% of total EU OPT) and in footwear (21%). Also, it is interesting to note that, despite very low absolute levels, Italy represents the majority of EU OPT in the pharmaceutical sector (77%)¹⁰⁴ (as well as in organical chemicals: 67%).

The other countries involved in OPT operations in CEECs are massively oriented to the T&C sector: the Netherlands and Denmark, as well as the United Kingdom but with almost irrelevant absolute levels (around 90% of their OPT operations in CEECs, i.e. ECU 250 and 170 M, in the Dutch and Danish case, respectively). As to French partners, they also undertake some OPT activities in the electrical machinery sector, and they used to be more active in the footwear sector (see below the analysis in dynamic terms). As a result, the share of T&C in total French OPT with CEECs is 'only' 83%.

Some special cases of surprisingly dynamic second positions are worth noting. For example, the Dutch and Belgium OPT presence in the sector of electrical machinery

¹⁰³ Everything is made "relative" by the overwhelming domination of Germany.

¹⁰⁴ Such figures probably reflect the activities of a limited number of firms, if not that of one unique company.

(approximately ECU 15 M each) and the Danish OPT activity in the footwear industry (ECU 10 M).

Another way to grasp differences from home-country to home-country is to go beyond the magnitude of the volumes involved, and to look at the very structure of OPT trade.

For example, the sectors of electrical and mechanical machinery occupy significant positions in the German structure (resp. 2nd and 4th position), but on the face of it, Italy undertakes OPT only in the mechanical machinery sector, whereas, on the contrary, France and the Netherlands have OPT only in the electrical machinery sector.

Also, in the German product structure, it is worth noting the third position (after T&C, and electrical machinery) of furniture which is almost the exclusive source of EU OPT in the CEECs.

As to Italy, it has definitely the most peculiar product structure characterised as it is by a strong edge in footwear, plastics (second and third after the T&C sector, with ECU 30 M and 17 M, respectively), as well as in pharmaceuticals.

• Summing up ...

- Germany is always the major, and often the only source of OPT in CEECs (in particular in furniture, in mechanical machinery and in the electrical machinery)
- the Italian OPT pattern is relatively diversified, with sectors like footwear, plastics, mechanical machinery, and pharmaceuticals registering some significant levels of OPT
- Dutch firms and although with lower absolute levels, Danish ones, undertake OPT almost exclusively in T&C

From the viewpoint of host countries

Even though T&C comes systematically first in the product structure of all the CEECs, it is Poland which is definitely the most specialised in T&C: the OPT business in the Polish sector is indeed worth ECU 1.5 bn (which is 80% of all Polish OPT from the EU). In other terms, more than half of EU OPT in the sector goes to Poland (56% of EU OPT to CEECs in T&C is geared to Poland).

Table 7. OPT exports to the EU12 (1000 ECU), proportion in total OPT to the EU12 (%), and proportion in total OPT exports from the CEEC4 to the EU12 (%).

| Czech Republic | | | Hungary | | | Poland | | |
|-----------------|--------|---------|----------------|--------|---------|-----------------|---------|---------|
| | 1995 | %EU | | 1995 | %EU | | 1995 | %EU |
| TT | 900998 | 100.00% | TT | 882079 | 100.00% | TT | 1836823 | 100.00% |
| T&C | 378691 | 42.03% | T&C | 587969 | 66.66% | T&C | 1482639 | 80.72% |
| elec. mach. | 180238 | 20.00% | elec. mach. | 136407 | 15.46% | furniture | 126295 | 6.88% |
| mech. mach. | 80102 | 8.89% | shoes | 61086 | 6.93% | elec. mach. | 72170 | 3.93% |
| shoes | 37036 | 4.11% | mech. mach. | 24826 | 2.81% | shoes | 40809 | 2.22% |
| cars | 32789 | 3.64% | plastics | 20592 | 2.33% | edible prepara | 25752 | 1.40% |
| furniture | 21966 | 2.44% | furniture | 16071 | 1.82% | cars | 16090 | 0.88% |
| I&S | 21153 | 2.35% | leather | 10351 | 1.17% | mech. mach. | 13364 | 0.73% |
| optical instr. | 19655 | 2.18% | cars | 5595 | 0.63% | leathers | 9774 | 0.53% |
| plastics/rubber | 18047 | 2.00% | I&S | 2964 | 0.34% | optical instr. | 7970 | 0.43% |
| manufact. misc | 16546 | 1.84% | clocks | 2755 | 0.31% | plastics | 6378 | 0.35% |
| printing | 13200 | 1.47% | optical instr. | 2393 | 0.27% | I&S | 6107 | 0.33% |
| base metal | 13198 | 1.46% | pharmaceutica | 2357 | 0.27% | misc. manufac | 4552 | 0.25% |
| toys | 9892 | 1.10% | toys | 1493 | 0.17% | fish/crustacean | 3415 | 0.19% |
| edible prep. | 9788 | 1.09% | organic chemi | 1329 | 0.15% | paper | 2622 | 0.14% |
| glassware | 8609 | 0.96% | aluminium | 1021 | 0.12% | wood | 2471 | 0.13% |

Another interesting feature concerning the Polish OPT product structure has to do with the sector of furniture. As a matter of fact, it is one of the few sector which, after T&C, registers significant absolute levels (ECU 126 M); its importance stems also from the fact that the sector is almost the only destination of EU OPT (74% of all EU OPT to CEECs in furniture). The sector of edible preparations is (even more) marginal from the Polish viewpoint, but here again, it attracts the vast majority of EU OPT in the sector (72%).

The Czech structure is far more diversified with a lot of sectors concerned. This is because OPT in T&C represents a lower share compared to the other CEECs (only 42% of the OPT activities of Czech firms), and it is not particularly attractive to EU firms (only 14% of EU OPT in CEECs in the sector). On the face of it, the sector of electrical machinery occupies quite an important second position with the highest absolute levels throughout the region (ECU 180 M i.e., 20% of Czech OPT). Indeed, around half of EU OPT in the sector goes to the Czech Republic. The Czech Republic is also an incomparably preferred destination of the OPT activities of EU firms in the mechanical machinery sector (61% of EU OPT to CEECs in the sector, i.e., ECU 60 M). In general, it is worth noting that OPT in the Czech lands concern comparatively more 'sophisticated' goods. Ranked by decreasing absolute levels, they are: cars (56% of EU OPT), iron and steel (64%), photography (63%), printing (95%), base metals, and glassware (both 94%).

Finally, Hungary occupies an intermediate position: T&C is more important than in the Czech case, but of course, less than in the Polish one (ECU 588 M). Electrical machinery, in second position attracts significant amounts of OPT from the EU, but less than the Czech

Republic (ECU 136M). But it is nevertheless interesting to note two poles of relative specialisation: footwear (43% of EU OPT to CEECs in the sector, i.e., ECU 61 M), and plastics (also 43%, i.e., ECU 20 M), and with lower absolute levels in pharmaceuticals and organic chemicals (85%, and 75% of EU OPT, respectively).

• Summing up, some salient points emerge:

- the systematic pre-eminence of T&C in the product structure of host countries is to be qualified: the sector is overwhelmingly dominant in Poland, but its relative importance is much less marked in the case of the Czech Republic. It occupies an intermediate position in Hungary

- EU OPT in furniture is almost exclusively geared to Poland (second sector far behind T&C in the Polish commodity structure)

- the Czech republic is a privileged destination for OPT in the sectors of electrical machinery, and mechanical machinery (the first with higher absolute levels, but a lower share of EU OPT in the sector, the second with lower absolute levels, but a higher share)

- apart from the classic OPT-oriented T&C and electrical machinery sectors, Hungary is specialised in footwear and plastics.

Proportion of OPT in total trade and evolution

It was noted that taken as a whole, the foreign trade of both Poland and Hungary is characterised by a higher dependence on OPT than that of the former Czechoslovakia. Table 8 makes clear that this is very much the result of the weight of OPT in the two countries' T&C sectors: OPT represents 81% of total trade in the Polish T&C sector and 75% in the Hungarian sector. In the Czech Republic, instead, trade performance in T&C is less ascribable to OPT ("only" 51% of total trade is due to OPT).

Table 8. Total exports, and OPT re-exports (1000 ECU); proportion of OPT in total exports to the EU12 (%).

| F. Czechoslovakia | | | | Hungary | | | | Poland | | | |
|-------------------|------------|---------|-------|----------------|------------|--------|-------|-----------------|------------|---------|-------|
| | Tot. trade | OPT | OPT % | | Tot. trade | OPT | OPT % | | Tot. trade | OPT | OPT % |
| Total | 10475296 | 1163720 | 11% | Total | 6495043 | 882079 | 14% | Total | 11104300 | 1836823 | 17% |
| I&S | 1445447 | 23798 | 2% | mech. mach. | 1160352 | 24826 | 2% | T&C | 1829039 | 1482639 | 81% |
| T&C | 1120589 | 570958 | 51% | elec. mach. | 909449 | 136407 | 15% | furniture | 873687 | 126293 | 14% |
| elec. mach. | 1016520 | 200645 | 20% | T&C | 782319 | 587969 | 75% | cars | 813631 | 16090 | 2% |
| mech. mach. | 957789 | 92626 | 10% | iron & steel | 444897 | 2964 | 1% | elec. mach. | 688363 | 72170 | 10% |
| cars | 899955 | 37111 | 4% | cars | 373733 | 5595 | 1% | mech. mach. | 465636 | 13364 | 3% |
| plastics | 623284 | 20377 | 3% | plastics | 342430 | 20592 | 6% | edible preparat | 210752 | 25752 | 12% |
| furniture | 470435 | 27927 | 6% | shoes | 180229 | 61086 | 34% | shoes | 126888 | 40809 | 32% |
| glassware | 403854 | 8613 | 2% | furniture | 176137 | 16071 | 9% | optical instr. | 43866 | 7970 | 18% |
| shoes | 212549 | 41691 | 20% | leather | 75800 | 10351 | 14% | | | | |
| b. metal | 166912 | 13267 | 8% | pharmaceutica | 40367 | 1493 | 4% | | | | |
| optical instr. | 111758 | 20860 | 19% | optical instr. | 22996 | 2357 | 10% | | | | |
| leathers | 106179 | 18091 | 17% | toys | 4309 | 53 | 1% | | | | |
| toys | 69735 | 11148 | 16% | clocks | 3510 | 2755 | 78% | | | | |
| printing | 59986 | 13492 | 22% | | | | | | | | |
| misc. manufac | 40983 | 16585 | 40% | | | | | | | | |
| edible prep. | 32281 | 9788 | 30% | | | | | | | | |

In addition Table 8 makes clear several patterns of OPT dependence which are in general common to the countries under consideration, but with sometimes outstanding country-specific features.

For a start, there are sectors important for the general trade performance of the country which not only display significant absolute levels of OPT, but also relatively high rates of OPT proportions. In common, across the three countries is of course T&C. Far behind, electrical machinery characterise the product structure of both the former Czechoslovakia and Hungary (to a lower extent that of Poland). Finally, with lower absolute levels of OPT, but with quite impressive OPT proportions, the footwear industry.

In this first category, two sectors distinguish themselves: the mechanical machinery industry in the former Czechoslovakia, and the furniture sector in Poland. However, whereas the ex-Czechoslovakia is a dominant but not unique destination of EU OPT in the sector of mechanical machinery (Hungary in particular is characterised by a significant amount of transaction), furniture is an almost complete exclusivity of Poland.

Then comes a second category of sectors much more diversified from country to country; they are in general more marginal in the overall product structure of the CEECs but attract relevant OPT activity both in absolute and relative terms. These sectors are particularly numerous and diversified in the former Czechoslovakia: optical instruments, leather¹⁰⁵, toys, printing, miscellaneous manufactures ... are all sectors registering between ECU 10 M and 20 M,

¹⁰⁵ It is actually Slovakia which is responsible for this figure: the OPT proportion in the Slovak sector amounts to 38%.

i.e., between 15% to 40% of total trade. In Poland, electrical machinery and edible preparations, and in Hungary (with lower absolute levels) furniture and leather are sectors in a similar position.

Finally, there is the case of sectors ranking high in the structure of the strongest exports to the EU12, but which register only a marginal share of OPT. However, in absolute terms, the amounts of OPT involved are sometimes quite important: the automotive industry in both the former Czechoslovakia and Poland, plastics in both the former Czechoslovakia and Hungary, and the mechanical machinery industry in Poland and Hungary (and to an incomparably lower extent pharmaceuticals in Hungary: 10%).

Table 9. Growth of total exports to the EU 12 between 1991 and 1995 (%), OPT proportions in total exports in 1991 and 1995 (%), and growth of OPT proportions in total exports between 1991 and 1995 (%).

| former Czechoslovakia | | | | Hungary | | | | Poland | | | | | |
|-----------------------|------|------|---------|-------------|-----------|------|------|---------|---------------|-----------|------|------|---------|
| tot 91-95 | % 91 | % 95 | % 91-95 | | tot 91-95 | % 91 | % 95 | % 91-95 | | tot 91-95 | % 91 | % 95 | % 91-95 |
| 158% | 8% | 11% | 36% | TT | 79% | 18% | 14% | -26% | TT | 79% | 14% | 17% | 23% |
| 873% | 8% | 8% | -4% | cars | 566% | 26% | 1% | -94% | optical instc | 76% | 3% | 18% | 304% |
| 572% | 23% | 20% | -13% | elec. mach. | 291% | 27% | 15% | -44% | 64 | 16% | 29% | 32% | 13% |
| 397% | 12% | 19% | 51% | mech. mach | 274% | 10% | 2% | -78% | T&C | 111% | 74% | 81% | 10% |
| 266% | 7% | 6% | -19% | toys | 205% | 28% | 4% | -87% | elec. mach. | 312% | 10% | 10% | 0% |
| 237% | 3% | 16% | 429% | pharmaceut | 104% | 36% | 10% | -71% | edible prep. | 23% | 13% | 12% | -5% |
| 209% | 17% | 10% | -43% | I&S | 95% | 1% | 1% | -3% | furniture | 190% | 21% | 14% | -31% |
| 192% | 6% | 4% | -32% | plastics | 74% | 3% | 6% | 99% | mech. mach | 75% | 8% | 3% | -66% |
| 179% | 1% | 3% | 146% | furniture | 54% | 13% | 9% | -29% | cars | 630% | 9% | 2% | -78% |
| 175% | 9% | 40% | 369% | T&C | 41% | 71% | 75% | 6% | | | | | |
| 174% | 27% | 20% | -26% | shoes | 37% | 77% | 34% | -56% | | | | | |
| 151% | 2% | 2% | 8% | clocks | 16% | 62% | 78% | 27% | | | | | |
| 133% | 32% | 51% | 61% | leathers | 11% | 29% | 14% | -53% | | | | | |
| 108% | 11% | 17% | 48% | misc. manu | -4% | 22% | 1% | -94% | | | | | |
| 102% | 1% | 2% | 74% | | | | | | | | | | |
| 88% | 10% | 22% | 122% | | | | | | | | | | |
| 16% | 1% | 30% | 2710% | | | | | | | | | | |

CEECs' sectoral distribution of OPT dependence (i.e., the proportion of OPT in total trade, by sector) sometimes displays significant changes from 1991 to 1995. A first approach to the evolution of the dependence of the four CEECs' foreign trade on OPT confirms the distinction between on the one hand Hungary, which OPT dependence decreases by 26%, and on the other hand the former Czechoslovakia where OPT proportion in total trade increases by 36% and 22%, respectively. As to the sectoral trend of OPT dependence, it is characterised by a clear divide between T&C which displays growing proportions of OPT in total trade, and almost all the other sectors which in general register diminishing dependence on OPT.¹⁰⁶

¹⁰⁶ It is important to note that such opposite trends are -partly- ascribable to the nature of the pertaining trade measures and their respective liberalisation procedures: whereas in T&C the latter consists of an increase of specific OPT quota which translates into an increase of OPT trade, in the other sectors subject

That said, there are numerous country- and sector-specific features. Similar trends across the 3 (4) countries concern for example the sectors of machineries. The sector displays the strongest falls is the mechanical machinery: -78% in Hungary, and -43% in the former Czechoslovakia (-66% in Poland, but the absolute levels are much less significant). It is worth noting how indeed, the rate of dependence in the Czechoslovak sector in 1991 was very significant (17%, compared to 10% in Hungary).

But decreases in the electrical machinery are no less significant: -44% in Hungary, and -13% in the former Czechoslovakia. Interestingly enough, in both countries, the sector used to be characterised by high and similar proportions of OPT (with a peak in 1992 of 34% in Hungary, and 36% in Czechoslovakia).

Finally, it is worth noting a general disengagement from OPT activities in the automotive industry, but as the result of quite differentiated trends across the 3 countries. Indeed, the Hungarian sector used to be significantly dependent on OPT for its foreign trade performances: no less than 26% of exports in 1991 were actually ascribable to OPT in 1991 (i.e., 14 M ECU) whereas in both Poland and Czechoslovakia OPT dependence never really went beyond the maximum levels registered in the early years of the transformation (approximately 10%, i.e., in the case of the former Czechoslovakia: around 50 M).

A sector marked by important country-specific features is the footwear industry: OPT dependence decreases in Hungary and in the former Czechoslovakia (-56%, and -26%, respectively), but it increases in Poland (+13%). Therefore, even though the resulting OPT shares in total trade in 1995 are comparable (more than 30% in Poland and Hungary, and 20% in the former Czechoslovakia), starting levels were very different. Indeed, in 1991, no less than 77% of total Hungarian exports of footwear were actually OPT re-exports (i.e., ECU 100 M, to be compared with approx. 20-30 M i.e., slightly less than 30% total trade in both Poland and the former Czechoslovakia).

Two additional features are of some interest. For a start, the Hungarian plastic sector, although it is concerned by quite marginal amounts of transactions (not more than 6% of total exports) is the only one which together with T&C registers an increase of OPT proportions. Also, the sector of base metals in the former Czechoslovakia is very specific in attracting OPT activity. What is more, the trend of the OPT share in the total exports of the sector is very uneven: from 8% dependence in 1991 to 8% dependence in 1995 ... but with a peak of 40% in 1992!

Finally, furniture is a sector reducing its OPT dependence in general, but it is in the Polish sector that the trend is really significant (the rate is -31% between 1991 and 1995).

to decreasing tariffs, OPT trade tends to be statistically underrated as incentives to declare OPT as such diminish.

• Summing up ...

-whereas the Polish and the Hungarian T&C sectors are significantly dependent on OPT the Czechoslovak sector is characterised by the lowest share

-OPT proportions in 'important' sectors is often comparable: 14% in the Polish furniture sector, 10% in the Czechoslovak sector of mechanical machinery, 15% and 20% in the Hungarian and Czechoslovak sectors of electrical machinery

-the same goes in the footwear sector: more than 30% of OPT in total exports in Poland and Hungary, 20% in the former Czechoslovakia

-the automotive industry, plastics and mechanical machinery in general register marginal shares of OPT in total exports

-the proportion of OPT increases in the T&C sectors of the 3 countries, it decreases in all the other sectors of the 3 countries. Rare significant exceptions are optical instruments and miscellaneous manufactures in the former Czechoslovakia, plastics in Hungary, and footwear in Poland

-the path followed by the decreases of OPT proportions can be quite different with distinct starting levels or peaks of OPT dependence: this is the case in the automotive industry, in the sector of footwear, and in base metals.

Contribution of OPT to CEECs trade performances

Table 10 ranks sectors according to their contribution to the growth of CEECs exports to the EU¹⁰⁷: electrical and mechanical machineries in both the former Czechoslovakia and Hungary; T&C and the automotive industry in the three countries, but more markedly in Poland; irons and steel (I&S), especially in the former Czechoslovakia; and the furniture industry in Poland are all sectors of particular importance for the overall trade performance of CEECs.

¹⁰⁷ The formula used is the following, for exports (X) in sectors i, between 1991 and 1995:

$$(X_{i95} - X_{i91}) / (tot95 - tot91).$$

The main advantage of this indicator is that it corrects dynamic trends by the absolute levels concerned.

Table 10. Sectors contribution to the total growth of total trade (TT), and OPT contribution to the evolution of sectors' total trade (OPT). In %, between 1991 and 1995.

| Former Czechoslovakia | | | Hungary | | | Poland | | |
|-----------------------|------|-----|----------------|------|------|-------------|------|-----|
| Items | TT | OPT | Items | TT | OPT | Items | TT | OPT |
| I&S | 14% | 2% | mech. mach. | 30% | -1% | T&C | 20% | 88% |
| elec. mach. | 13% | 19% | elec. mach. | 24% | 11% | cars | 14% | 1% |
| mech. mach. | 10% | 6% | cars | 11% | -3% | furniture | 12% | 11% |
| T&C | 10% | 66% | T&C | 8% | 86% | I&S | 11% | 0% |
| cars | 9% | 3% | I&S | 8% | 1% | elec. mach. | 11% | 10% |
| plastics | 6% | 4% | aluminium | 7% | 0% | wood art. | 7% | 1% |
| furniture | 5% | 5% | plastics | 5% | 10% | mech. mach. | 4% | -5% |
| wood art. | 3% | 0% | furniture | 2% | 2% | plastics | 3% | 2% |
| glassw. | 3% | 3% | shoes | 2% | -83% | paper | 3% | 1% |
| paper | 3% | 2% | optical instr. | 2% | -1% | copper | 3% | 0% |
| b. metals | 2% | 8% | wood | 1% | -1% | other | 3% | 0% |
| shoes | 2% | 16% | Total | 100% | 7% | Total | 100% | 20% |
| aluminium | 2% | -1% | | | | | | |
| other | 2% | -1% | | | | | | |
| optical instr. | 1% | 20% | | | | | | |
| Total | 100% | 13% | | | | | | |

It is no coincidence that most of the above sectors are themselves quite dependent on OPT for their dynamism. This is obviously the case of the T&C industry where OPT explains 88%, 86%, and 66% of the exports' growth in Poland, Hungary and the former Czechoslovakia, respectively. It is also true, albeit with lower figures for electrical machineries in the former Czechoslovakia, and in Hungary (19% and 11%, respectively), and for furniture in Poland (11%). In addition, it is worth noting the significant contribution of OPT in the former Czechoslovakia's footwear industry, even though the sector is not among the most dynamic in aggregate terms (16% of OPT contribution, and 2% to total trade). The same happens in the Hungarian plastics sector (10% of OPT contribution, and 5% to total trade). On the contrary, OPT contribution is very modest for the Czech mechanical machineries and the Czech and Polish car parts industry. It is frankly negligible in I&S.

In Table 11, yet another use of the 'contribution' indicator makes clear the fundamental role that OPT played in the reorientation of trade in certain sectors. The contribution of OPT in one sector to the growth of the aggregate figure of total trade¹⁰⁸ (i.e., the exports of *all* sectors as opposed to the above contribution of OPT to the growth of *one sector*) lets appear very

¹⁰⁸ The formula is, this time:
 $(OPT_{i95} - OPT_{i91}) / (toti_{95} - toti_{91})$.

significant figures. T&C is unsurprisingly at the very top of the ranking of the strongest contributions, but in quite different proportions over the 3 countries under scrutiny: In Poland, OPT in the sector explains 17% of the growth of Polish total exports to the EU12 between 1991 and 1995. The corresponding figure is also very relevant even though it is much lower in the cases of Hungary and the former Czechoslovakia: 7% in both cases.

Table 11. OPT contribution to total trade performance, and evolution of OPT proportion in total trade with the EU12, 1991-1995 (%).

| Former Czechoslovakia | | | Hungary | | | Poland | | |
|-----------------------|----------|---------|-------------|----------|---------|---------------|----------|---------|
| Items | Contrib. | % evol. | Items | Contrib. | % evol. | Items | Contrib. | % evol. |
| Tot. trade | 12.96% | 36% | Tot. trade | 7.41% | -26% | Tot. trade | 20.40% | 22% |
| t&c | 6.53% | 61% | t&c | 6.80% | 6% | t&c | 17.29% | 10% |
| elec. mach. | 2.59% | -13% | elec. mach. | 2.58% | -44% | furniture | 1.29% | -31% |
| mech. mach. | 0.62% | -43% | plastics | 0.51% | 99% | elec. mach. | 1.12% | 0% |
| shoes | 0.33% | -26% | furniture | 0.05% | -29% | shoes | 0.20% | 13% |
| cars | 0.29% | -32% | I&S | 0.05% | -3% | optic. instr. | 0.15% | 504% |
| furniture | 0.29% | -19% | clocks | 0.03% | 27% | cars | 0.12% | -78% |
| optic. instr. | 0.28% | 51% | glassware | -0.01% | -99% | edible prep. | 0.08% | -5% |
| plastics | 0.27% | 146% | printing | -0.02% | -76% | plastics | 0.06% | -10% |
| misc. manufa | 0.24% | 369% | edible | -0.05% | -63% | I&S | 0.02% | -43% |
| I&S | 0.23% | 8% | toys | -0.08% | -87% | printing | -0.01% | -89% |
| leathers | 0.19% | 48% | mech. mach. | -0.21% | -78% | glassware | -0.01% | -68% |
| b. metals | 0.18% | -4% | cars | -0.31% | -94% | mech. mach. | -0.19% | -66% |
| toys | 0.16% | 429% | leathers | -0.34% | -53% | | | |
| printing | 0.16% | 122% | shoes | -1.41% | -56% | | | |
| edible prep. | 0.15% | 2710% | | | | | | |
| glassware | 0.10% | 74% | | | | | | |

The ranking of the other sectors confirms the country-specific features outlined above: the strong and similar contribution of OPT in the sector of electrical machinery in the former Czechoslovakia and Hungary (which explains more than 2.5% of the trade performances in the two countries between 1991 and 1995), the role of OPT in the sectors of furniture in Poland, plastics in Hungary, and mechanical machinery in the former Czechoslovakia.

What is more, Table 11 illustrates the general negative trend that OPT has undergone in Hungary: of particular interest is the strong negative contribution registered by OPT in the footwear sector, but also in the leather, the automotive, and the mechanical machinery industries... (etc).

The contrast with the trend characterising OPT in the former Czechoslovakia is clear; indeed almost no (or only very insignificant) negative OPT contributions takes place there. On the face of it, the Czechoslovak structure of OPT contribution turns out to be quite diversified with lower levels which nevertheless apply on a wide range of sectors (indeed there are OPT

contributions of some relevance in sectors like optical instruments, base-metal, and *printing* ... which are not particularly 'OPT-prone' in the other CEECs).

3. Mapping OPT relations between the EU12 and the CEEC4: synthesis

Figure 2 combines the above considerations concerning sectoral and geographical OPT patterns between the EU12 and CEEC4; it answers the question as to which country has which privileged partner, and what product structure characterises such bilateral flow.

Figure 2. OPT exports from the CEECs to the EU countries, bilateral flows, by sectors (M ECU), 1995.

| 1995 | Germany | Netherlands | Italy | France | Denmark | EU12 |
|----------|---|---|--|--|--------------|---|
| Poland | 176 M: T&C (160 M) Electrical (4.5 M) | 32 M: T&C (21 M) Footwear (7 M) Mechanical (1.4 M) | 82 M: T&C (71 M) Electrical (5 M) Leather (1.5 M) | | | 1.8 bn T&C: 1.5 bn Furniture: 126 M Electrical: 72 M, Footwear: 40 M, Edib: 25 M Cars, mechanical, leather: 10 - 16 M Optical, plastics, I&S, misc: 5 - 8 M |
| Czech R. | 840 M: T&C (350 M), Electrical (170 M) Mechanical (77 M) Footwear, cars (ca 30 M each) Furniture, optical, I&S (ca 20 M) Plastics, misc, printing (ca 17 M) Base metal (13 M) Toys, edible, glassware (8 - 10 M) Leather, clocks (5 - 6 M) | Mechanical (2.5 M) | | | | 900 M T&C: 380 M Electrical: 180 M Mechanical: 80 M Footw, cars: ca 35 M, Furnit, I&S, opti, plast: ca 20 M, print, misc: 17 M, E, metal: 13 M, Toys, edib, glassw: 9 M, Leather, clock, perfum, rail: 4-7 M |
| Hungary | 550 M: T&C (330 M), Electrical (110 M) Footwear (40 M) Mechanical (23 M), Furniture (16 M) Leather (8 M) Car, plant (3-4 M), Clocks, toys (1.5 M) | 65 M: T&C (60 M) Electrical (4 M) | 137 M: T&C (89 M) Plastic, footwear (17 M each) Elec, pharmaceutical (2-3 M) | 68 M: T&C (62 M) Electrical (2 M) | | 880 M T&C: 588 M Electrical: 136 M Footw: 61 M, Mech: 25 M, Plast: 20 M Furnit, leather: 10-16 M, Carr: 6 M 263 M |
| Slovakia | 170 M: T&C (110 M) Electrical (20 M), mechanical (12 M) Leather (7 M) Railway (3-5 M), cars (3 M) | | | | | T&C: 192 M Elec: 20M, Mech: 13M, Leather: 10M Furniture, footwear, cars: 4 - 6 M |
| CEEC4 | 2.9 bn T&C: 1.8 bn electrical: 360 M furniture: 160 M mechanical, footwear: ca 100 M, cars: 50 M edible, leather, optic, plastics, I&S: ca 30 M print, misc: 20 M, E metal, box: 13 M Glassw, clocks, rail: 6-9 M, Perf: 4.5 M | 280 M T&C: 250 M electrical: 15 M furniture, footwear: 2.3 M | 214 M T&C: 140 M footw: 30 M plastic: 17M electrical: 5 M mechanical: 4 M cars, pharmaceuticals ca 2 M | 191M T&C: 190 M electrical: 11M footwear, leather, car ca 3-4M | 170 M T&C | 3.9 bn (14%) T&C: 2.6 bn (71%) electrical: 410 M (16%) furnit: 170M (11%), footw: 144M(28%), mech: 131M (5%), cars: 59 M (3%), plastics: 47 M (4%) leather: 38 M (13%), edib: 36M (10%), I&S: 33 M (1%), Print: 14 M (16%), Glassware: 9 M (1%) |

Overall, the product structure of the bilateral flows between CEECs, and their main EU partners varies to a large extent. For example, German firms engage OPT with Polish partners primarily in the sectors of T&C and furniture. Germano-Czech OPT relations, instead, are comparatively more important in the sectors of electrical machinery, and, to a lower extent in the mechanical machinery. As to German OPT activities in Hungary, they used to be important in the mechanical and footwear industries. In 1995, besides T&C, they mainly take place in the sector of electrical machinery.

In addition, it is interesting to note the diversification of the German OPT activities in the former Czechoslovakia. Besides the traditional sectors, German firms are active in the printing and leather industries, and although with much lower proportions of OPT in total trade, in the sectors of glassware, plastics and iron and steel.¹⁰⁹

It is also interesting to note the privileged OPT partnerships between firms in Hungary and in Italy. Apart from T&C, at least two Italo-Hungarian OPT networks are important: plastics and footwear.

Thus, OPT is an important factor accounting for the dynamism of CEECs trade to the EU which contributed to the process of trade reorientation in a significant way. So much so that in certain sectors like T&C, CEECs' foreign trade has grown impressively dependent on OPT with the EU in general and Germany in particular.

This raises concern as to the prospects of OPT in CEECs: were it suddenly to stop on the grounds of unfavourable conditions like wage increases, would CEECs' foreign trade drop proportionately?

The above statistical analysis shows that in certain sectors (mechanical machinery, car parts ...), and in certain countries (especially Hungary), OPT decreases in the context of very dynamic trends of 'direct' trade. On the contrary, in T&C, OPT increases very fast in absolute, as well as in relative terms.

There are two difficulties with these results. First, such generalities at a fairly aggregate level hardly conceal any general and systematic pattern of evolution. What is more, the question is left open as to the exact meaning of such trends. For example is the decrease of OPT trade a sign that foreign partners ended their engagement, or is it that they upgraded their commitment with the result that OPT transactions are no longer counted as such?

¹⁰⁹ Other sectors concerned which are not presented in the table are: base metal, optical instruments, toys and clocks.

Further considerations are needed to identify first the possible scenario characterising the evolution of OPT and their exact significance, and then the circumstances in which such scenario are most likely to occur.

3.2 The terms of the OPT (inter)dependence: a qualitative assessment

Asking the question of the prospects of the OPT activities of EU firms in CEECs makes it necessary to go beyond the blunt statistical truth and to carry out a more qualitative assessment of the very nature of OPT partnerships between EU and CEECs firms. In a nutshell, the question at stake is the following: are EU firms going to withdraw, and if yes, are local partners ready to take over OPT production on their own?

Ideally, a statistical analysis combined with evidence from fieldwork offer the means to determine the actual and the prospective evolutions of OPT relationships (See Annexes 2 and 3). Whereas the former determines which countries and sectors are characterised by which scenario, the latter identifies the profile of the firms involved in each of such scenario.

Before embarking in such analysis, however, it is worth further investigating the real implications of OPT from the viewpoint of local firms. As a matter of fact, the above alternative takes a particular relevance in the face of the potential risks characterising OPT as a vehicle of integration. To the 'aggregate' dependence of CEECs trade on OPT highlighted by the above statistical section, corresponds indeed a 'microeconomic' dependence of local firms on their foreign OPT partners. The latter might be decisive in determining the issue of the alternative between prolonged commitment / withdrawal.

1. Pros and cons at the firm-level

On the crude basis the above statistical evidence, one may conclude on the absolute beneficial effects of OPT. However, going beyond a mere trade approach and looking at the corporate network which gives rise to OPT trade flows yields a more mitigated assessment.

In fact, to the question of the terms under which OPT integrates CEECs production facilities, no simple and definitive answer is to be proposed. There is indeed a wide range of possible outcomes associated with OPT which entail quite differentiated local consequences at the level of the firm.

At first sight, OPT appears to be an almost providential solution to many of the problems that faced CEECs at the dawn of their economic transformation process in 1991. In particular, OPT might have been decisive in promoting trade reorientation in certain sectors by filling often huge production capacities left with no *raison d'être* by the sudden demise of the CMEA in 1991. In addition, OPT can be considered to be a solution to the shortage of good quality input necessary for successfully weathering international competition. It can be also argued that OPT is crucial as far as access to EU markets is concerned. First, OPT eases trade restrictions set up by the EU which would otherwise dissuade exports to the Community. Second, OPT offers a means for exporting abroad without having to fulfil often very demanding conditions in order to penetrate local distribution channels. Also, OPT is an ideal solution to the problem of 'adverse selection' that forces producers with no popular trademark to fix their prices lower than if their brand were renowned. Last but not least, OPT is a straightforward solution to solve the difficulties pertaining to the lack of managerial experience in the field of international relations.

But the price to pay for the above advantages is quite dear in terms of independence. As a matter of fact, a local firm engaging in OPT activities has to sacrifice its market power to the benefit of its foreign partner as it becomes dependent on the latter, first, for inputs, and second, to market the output. In addition, there is a series of mechanisms which actually deepens the state of dependence of the local firms, making it difficult for the latter to recover autonomy. For example the fact that goods produced under an OPT agreement are traded under the trademark of the EU partner prevents a local brand from gaining the recognition necessary for potential subsequent autonomous penetration of foreign markets. This is particularly pernicious as the ability of the local partner to take over production on his own in case of the withdrawal of the EU firm seriously put at risk.

Another drawback is that OPT concerns often very simple and labour-intensive transformation tasks and risks to neglect or even erode the potential technological capabilities of local partners, forcing the latter to specialise in labour intensive goods. What is more, it can be argued that the profitability conditions attached to OPT are likely to be unfavourable. For example, if the depreciation of machines used in the production process is not taken into account in the computation underlying an OPT contract, margins of profit decrease with time; the life span of the machinery then determines the end of the co-operation between the two partners ... and perhaps also the closing down of the local firm.¹⁰ Equally unfavourable can be the outcome in terms of development activities of the local OPT firm. Involving only primary tasks, an OPT co-operation agreement has necessarily a limited contribution in promoting the spill over of technology and know how that one can expect from close contacts between partner firms.

¹⁰ However, because of the 'adverse selection' phenomena, it can be argued that the profitability conditions of OPT, if compared to those attached to direct exports are not, after all, so unfavourable.

Finally, at the macroeconomic level, the major criticism to be addressed to OPT is the consequence of local partners' dependence for input: if undertaken on a significant scale, OPT might cut the linkages between industries concerned by OPT and upstream sectors.

The state of dependence in which local partners are placed is particularly worrying in the face of the extreme facility with which foreign partners can withdraw from their commitment. Were dissuading factors to materialise, foreign partners would find almost no 'exit' costs pertaining to their withdrawal. One of such factor is wage increases in the CEECs. For the moment, the advantage of CEECs in terms of labour costs are truly compelling.¹¹¹ But as soon as conditions become less favourable, foreign partners would find it most convenient to terminate their OPT engagement. As a matter of fact, OPT contracts do not demand long-lasting commitments; they can last only the time of one order (say 3 months), and be renewed only conditional on further demand.

In Annex 1, the simplified budget sheet of an hypothetical Czech firm in the Textile and Clothing sector undertaking OPT with a German partner shows that indeed, room for manoeuvre for OPT to keep on being a profitable business are narrow in the face of likely wage increases.

Overall, to assess the pros and the cons of OPT as a vehicle of economic integration between the EU and CEECs, at least two series of answer are to be proposed, which differ according to temporal considerations.

Up to now, the negative aspects of OPT are to be mitigated on the basis of the question as to whether an alternative to OPT was within the reach of the concerned firms. In this respect, it is worth introducing the distinction between *dependent* and *independent* exports [Stopford, Strange, 1991: 25]. If compared to independent exports, OPT is clearly characterised by more negative aspects; however, OPT becomes a second best if independent exports are difficult or impossible to achieve. Indeed, it might very well be that OPT represented for a majority of them almost a providential solution as of the demise of the CMEA in 1991.

But concerning the future, everything will depend on the prospect of OPT partnerships. In this respect, it is important to go beyond quantitative evidence to understand the real reach that OPT has in qualitative terms. If OPT partnerships are upgraded, OPT can be a first step in the formation of a more complex division of labour at the regional level. On the contrary, if foreign partners withdraw from their commitment, much depends on whether local firms can take over OPT production on their own, and thus pave the way for indigenous autonomous development.

¹¹¹ On average, CEECs wages are 8 to 10 times lower in CEECs. However, if productivity differentials are taken into consideration, the advantage is reduced.

In a scenario most adverse for local firms, foreign EU partners undertake OPT activities in order to take advantage of local low labour costs on a very short term basis. Once wages reach unfavourable levels, they re-relocate their production elsewhere, possibly further East, whereas local partners are not necessarily in a position to take over OPT production on their own.

Alternatively, even if the search for better production costs is still a primary determinant of an OPT strategy devised by EU firms, the latter upgrade their commitment and enter into more equal and 'two-ways'¹¹² partnerships with local counterparts; because they find other motives to carry out co-operation with local firms, they become relatively insensitive to wage increases.

Yet another possibility is that local firms take advantage of a good bargaining position and profit from an OPT agreement to strengthen their ability to compete on the world markets. They then manage to progressively reduce their recourse to OPT, and eventually recover complete autonomy.

In the following an attempt is made to determine whether and where foreign firms *actually* withdraw from their commitment, and whether and where local partners are ready to take over OPT production on their own.

2. Evidence from statistics: the identification of 'OPT networks'

It is the objective of the present section to use OPT statistics in order to provide a provisional answer concerning the qualitative evolution of OPT partnerships. But before embarking on the analysis of the prospective evolution of OPT partnerships, it is necessary to adopt a pertinent unit of analysis enabling to capture the many possible variations. The notion of 'OPT production networks', i.e., 'trinities' formed by the host country, the home country, and the sector concerned offers a useful solution at the 'meso level'.

In the following figure, the most relevant OPT networks have been selected on the basis of a quantitative criteria.¹¹³ Their main features are presented (see Annex 2 for the source).

¹¹² Mytelka, 1995.

¹¹³ It is worth noting that there are OPT networks involving smaller amount of transaction but which can nevertheless be quite interesting with respect to the issue of the regional division of labour (e.g. between Italians and Hungarians in pharmaceutical products, but also more generally in sectors like toys, and clocks).

Figure 3. OPT exports, direct exports and total exports, by 'OPT networks', 1995 (1000 ECU).

| Partners | Sect. | OPT | Direct | Total | % |
|----------|---------|---------|--------|---------|-----|
| Germ-Pol | t&c | 1049215 | 156533 | 1205748 | 87% |
| Germ-CS | t&c | 456734 | 271091 | 727825 | 63% |
| Germ-H | t&c | 332844 | 92784 | 425628 | 78% |
| Nl-Pol | t&c | 155934 | 16755 | 172689 | 90% |
| It-H | t&c | 88811 | 34533 | 123344 | 72% |
| Fr-Pol | t&c | 71070 | 30668 | 101738 | 70% |
| Fr-H | t&c | 62222 | 14263 | 76485 | 81% |
| Germ-CS | shoes | 32222 | 85476 | 117698 | 27% |
| Germ-H | shoes | 40558 | 89167 | 129725 | 31% |
| Germ-Pol | shoes | 23358 | 50277 | 73635 | 32% |
| Fr-CS | shoes | 3639 | 16348 | 19987 | 18% |
| It-H | shoes | 17519 | 27702 | 45221 | 39% |
| Germ-CS | elec | 189006 | 637170 | 826176 | 23% |
| Germ-H | elec | 111554 | 487435 | 598989 | 19% |
| Germ-CS | mech | 88855 | 597816 | 686671 | 13% |
| Germ-H | mech | 23270 | 585598 | 608868 | 4% |
| Germ-Pol | mech | 10039 | 243757 | 253796 | 4% |
| Germ-Pol | furnit | 119463 | 627883 | 747346 | 16% |
| Germ-CS | cars | 32606 | 538540 | 571146 | 6% |
| Germ-Pol | cars | 14727 | 289863 | 304590 | 5% |
| Germ-H | cars | 3981 | 252185 | 256166 | 2% |
| Germ-CS | plast | 20169 | 376844 | 397013 | 5% |
| It-H | plast | 16493 | 81893 | 98386 | 17% |
| Nl-Pol | edib | 3319 | 24749 | 28068 | 12% |
| Germ-Pol | edib | 22391 | 121917 | 144308 | 16% |
| Germ-CS | edib | 9788 | 15920 | 25708 | 38% |
| Germ-CS | I&S | 21470 | 990944 | 1012414 | 2% |
| Germ-CS | print | 13492 | 33954 | 47446 | 28% |
| Germ-CS | leather | 14101 | 39804 | 53905 | 26% |
| Germ-CS | glassw | 8363 | 226310 | 234673 | 4% |

Trajectories

The present section provides a provisional identification of the evolution of the above OPT networks. Although clearly imperfect, OPT trade statistics offer a first source of information for assessing the qualitative evolution undergone by OPT partnerships between EU and CEECs firms which make possible a classification of the latter.

It is proposed to concentrate on the respective evolutions of direct and OPT trade, i.e., in other terms, on the evolution of OPT proportions in total trade. Whether OPT proportion increases, and if it does so faster than direct trade makes possible some speculation on the possible prospect of OPT partnerships:

-OPT growths which are stronger than the increases registered by direct trade (i.e., growing OPT proportions in total trade) correspond to the prolonged commitment of foreign partners on a strict OPT basis, i.e., without signs of actual upgrading.

-On the face of it, decreasing OPT proportions due either to growths of direct trade which are stronger than that of OPT, or to decreasing absolute levels of OPT are signs of the transformation of the OPT partnerships:

-when OPT keeps on growing in the context of very dynamic direct trade, chances are that upgrading is taking place. As a matter of fact, foreign partners are obviously still present, and they probably want to participate to the distribution of the gains resulting from enhanced trade performances.

-when OPT decreases in the context of very dynamic direct trade, it possibly corresponds to a scenario where local producers take over the OPT production on their own, especially if OPT proportions are negligible in total trade.

-when OPT decreases in the context of rather depressed performances of direct trade, OPT is clearly a follower which does not help, nor hinder the indigenous trade performances.

1. Absolute increases of OPT

1.1 The case of the T&C industry

All OPT networks in T&C fall into the category characterised by strong growth rates of OPT in the context of rather weak growth of direct trade (if not absolute decreases), with overall resulting satisfactory performances of total trade.

Proportions of OPT in total trade reach outstanding levels following continually increasing trends. Generally speaking, there are only mild signs of a deceleration of OPT growth. Sometimes, OPT literally takes over direct trade, i.e., that OPT dynamism more than compensates absolute decreases of direct trade.

Table 12. OPT and direct trade (1000 ECU), and OPT proportion in total trade (%), by OPT networks

| | | 91/92 | | 92/93 | | 93/94 | | 94/95 | | 91 | 92 | 93 | 94 | 95 | 1991/1995 | | |
|----------|-----|-------|-----|-------|------|-------|------|-------|------|-----|-----|-----|-----|-----|-----------|-----|-------|
| | | opt | dir | opt | dir | opt | dir | opt | dir | % | % | % | % | % | opt | dir | total |
| Germ-Pol | t&c | 23% | 50% | 31% | 16% | 22% | -13% | 12% | 12% | 84% | 81% | 83% | 87% | 87% | 120% | 68% | 111% |
| Germ-CS | t&c | 61% | 29% | 56% | -1% | 42% | 6% | 8% | 12% | 40% | 43% | 57% | 64% | 63% | 283% | 52% | 143% |
| Germ-H | t&c | 6% | 51% | 11% | 9% | 9% | -19% | -1% | -7% | 78% | 71% | 71% | 77% | 78% | 28% | 24% | 27% |
| Nl-Pol | t&c | 61% | -1% | 61% | 103% | 17% | -6% | 19% | -40% | 74% | 83% | 79% | 82% | 90% | 263% | 13% | 199% |
| It-H | t&c | 92% | 25% | 47% | -41% | 27% | 31% | 14% | 5% | 39% | 50% | 71% | 70% | 72% | 309% | 3% | 123% |
| Pr-Pol | t&c | | | | | | | | | 54% | | | 70% | | 94% | 0% | 51% |
| Pr-H | t&c | | | | | | | | | 73% | | | 81% | | 58% | 0% | 43% |

OPT proportions in total trade are about 80% sometimes even reaching 90% between the Netherlands and Poland. The proportion rates never go below 60% (in the Germano-Czech case).

One peculiarity concerns the relations between German and Hungarian partners which are marked, as of 1994, by a decrease of OPT in absolute terms, parallel to the negative evolution of direct trade. Overall, total Hungarian exports performances are particularly weak, especially if compared to those of the other CEECs.

One interpretation is that OPT increases strongly because restrictions measures on direct trade are binding constraints. Because they develop on a fairly competitive and healthy basis, local firms come against to trade protection measures still in place during the process of trade liberalisation under the form of quotas. Thus, if they want to access the EU markets, local producers have few other options than to integrate into a vertical production chains which extremes are controlled by a foreign OPT partner.

1.2 Other sectors characterised by flat evolutions of direct trade

Other OPT networks are characterised by similar growing evolutions of OPT in the context of weak increases of direct trade; but contrary to the T&C case, the resulting performances of total trade are rather poor. Indeed, even if growing, the eventual proportions of OPT in total trade are incomparably lower (approximately comprised between 10 and 30%).

Table 13. OPT and direct trade (1000 ECU), and OPT proportion in total trade (%), by OPT networks

| | | 91/92 | | 92/93 | | 93/94 | | 94/95 | | 91 | 92 | 93 | 94 | 95 | 1991/1995 | | |
|----------|--------|-------|------|-------|------|-------|-----|-------|-----|----|-----|-----|-----|-----|-----------|------|-------|
| | | opt | dir | opt | dir | opt | dir | opt | dir | % | % | % | % | % | opt | dir | total |
| It-H | ptast. | 132% | 44% | -3% | -29% | -8% | 6% | 65% | 43% | 8% | 13% | 17% | 15% | 17% | 244% | 55% | 71% |
| Germ-Pol | edib. | 105% | 8% | 43% | -7% | 28% | -9% | -1% | 39% | 6% | 11% | 15% | 20% | 16% | 274% | 27% | 42% |
| Germ-CS | edib. | 140% | -33% | 66% | -40% | 322% | 25% | 94% | 46% | 1% | 5% | 12% | 32% | 38% | 3163% | -27% | 16% |

These networks are: Italo-Hungarian partnerships in plastics, and, in the sector of edible preparations, Germano-Polish and Germano-Czech partnerships. The Germano-Czech OPT relationships in the sector of edible preparations are characterised by dramatic absolute and relative increases. The eventual proportion of OPT in total Czech exports to Germany almost reaches 40%. Interestingly enough, Hungarian direct exports undergo an absolute decrease over the 1991-1995 period which is unique among the observed OPT trajectories.

In contrast to the T&C case, OPT is likely to increase strongly because of serious domestic problems harming the ability of local firms to compete on the world markets. Such problems can be situated either 'upstream' the production chain (e.g., no input available locally), or 'downstream' (e.g., the difficulty of entering foreign markets because of a lack of managerial skills, or because of a 'bad image'). That OPT provides a straightforward solution to such problems makes the recourse to OPT particularly vital to certain local firms. But in contrast to the T&C case, foreign partners might not be interested in seizing such opportunities for quasi-integration, and OPT proportions remains much lower. Because of their rather weak bargaining position, local firms are thus likely to be integrated into vertical chains of EU OPT partners on a short term and footloose basis, i.e., "on the cheap".¹⁴

1.3 Relative dynamism of direct trade

In a third category of OPT networks characterised by strong OPT increases, direct trade registers significant growth rates as well. As a result, total trade displays quite dynamic trends. However, the growth of direct trade notwithstanding, the major source of dynamism is still given by OPT. Indeed, OPT increases faster so that OPT proportions in total trade are continually growing. Different levels of OPT proportions (either significantly high, or extremely low) invite to distinguish between two cases.

¹⁴ In this case, in order to minimise the risks arising from the potential withdrawal of foreign partners, local firms might try to diversify their partners rather than to secure the commitment of one of them.

Table 14. OPT and direct trade (1000 ECU), and OPT proportion in total trade (%), by OPT networks

| | | 91/92 | 92/93 | 93/94 | 94/95 | 91 | 92 | 93 | 94 | 95 | 1991/1995 | | |
|---------|--------|-----------|-----------|---------|----------|-----|-----|-----|-----|-----|-----------|------|-------|
| | | opt dir | opt dir | opt dir | opt dir | % | % | % | % | % | opt | dir | total |
| Germ-CS | leath. | 41% 73% | 12% 6% | 38% 14% | 27% 4% | 22% | 19% | 19% | 22% | 26% | 176% | 117% | 130% |
| Germ-CS | print. | -7% 37% | 34% 39% | 75% 23% | 91% 19% | 21% | 15% | 15% | 20% | 28% | 317% | 180% | -80% |
| It-H | footw. | 643% 141% | 451% -24% | 48% 4% | 1% 15% | 2% | 7% | 34% | 42% | 39% | 6004% | 119% | 249% |
| Germ-CS | plast | 208% 17% | 19% 26% | 41% 60% | 39% 31% | 2% | 6% | 5% | 5% | 5% | 616% | 207% | 217% |
| Germ-CS | I&S | 71% 62% | -24% 15% | 46% 44% | 101% 28% | 2% | 2% | 1% | 1% | 2% | 282% | 243% | 244% |
| Germ-CS | glassw | 100% 37% | 84% 18% | 90% 11% | -51% 32% | 2% | 4% | 6% | 9% | 4% | 243% | 137% | 139% |

There is a first series of sectors registering high OPT proportions. OPT partnerships between German and Czech firms in leather, and in the peculiar sector of the printing industry, as well as Italo-Hungarian OPT exchanges in footwear all belong to this category. These networks are characterised by significantly high proportions in total trade (between 25 and 40%).

On the contrary, in glassware, I&S and in plastic, Germano-Czech OPT partnerships remain very marginal: between 2 and 5% of OPT in total trade (especially in I&S where the amounts involved are quite high, but the proportions in total trade really negligible).

1.4 Strong growth of direct trade

An interesting category of OPT networks registers simultaneous growths of direct and OPT trade. The cumulating of dynamism arising from both sources yields outstanding growth rates of total trade, but contrary to the previous case, direct trade increases faster than OPT transactions, with a consequent decrease of OPT proportions in total trade.

Table 15. OPT and direct trade (1000 ECU), and OPT proportion in total trade (%), by OPT networks

| | | 91/92 | 92/93 | 93/94 | 94/95 | 91 | 92 | 93 | 94 | 95 | 1991/1995 | | |
|----------|----|----------|-----------|----------|-----------|-----|-----|-----|-----|-----|-----------|-------|-------|
| | | opt dir | opt dir | opt dir | opt dir | % | % | % | % | % | opt | dir | total |
| Germ-CS | 64 | 503% 54% | 38% -19% | 34% 17% | -44% 143% | 18% | 46% | 59% | 62% | 27% | 518% | 255% | 302% |
| Germ-Pol | 94 | 19% 35% | 42% 42% | 22% 30% | -7% 47% | 26% | 24% | 24% | 23% | 16% | 93% | 266% | 220% |
| Germ-CS | 87 | 235% 51% | -27% -14% | 15% 10% | -19% 127% | 8% | 16% | 14% | 14% | 6% | 129% | 225% | 217% |
| Germ-Pol | 87 | 106% 48% | -35% 228% | 109% 18% | -47% 76% | 26% | 33% | 9% | 14% | 5% | 48% | 906% | 686% |
| Germ-CS | 85 | 179% 77% | 9% 96% | 24% 106% | 49% 58% | 37% | 48% | 34% | 24% | 23% | 461% | 1027% | 816% |
| Germ-H | 85 | 54% 14% | 13% 62% | 2% 70% | 7% 40% | 35% | 42% | 33% | 23% | 19% | 90% | 341% | 254% |
| Germ-CS | 84 | -10% 54% | 10% 33% | 15% 55% | 53% 40% | 27% | 18% | 15% | 12% | 13% | 75% | 342% | 269% |

This is so of many important OPT relationships involving German and Czech partners: in footwear, in the automotive industry, and in the sectors of electrical and mechanical machinery. German OPT in the Hungarian electrical machinery sector and Germano-Polish partnerships in the furniture and automotive industries also belong to this category. Even if they follow a decreasing trend, OPT proportions in the total trade of these OPT networks remain high (around 20%).

In this category, the dynamism of direct trade is accompanied by still non negligible growth of OPT. Even if trade barriers are being dismantled, and even if the level of competitiveness is obviously not a problem, OPT keeps on growing. This is an obvious sign that foreign partners are still engaged into their partnerships. It is sensible to think that they want to profit from dynamic trade performance, and are thus getting more involved in their partnership, making it more 'two-way', more stable. This could very well correspond to an upgrading scenario.

2. OPT decreases

Another series of OPT networks is characterised by extremely dynamic evolutions of direct trade, and generally fastly decreasing OPT transactions. Interestingly enough, when OPT follows decreasing trends, it does so almost always in the context of quite dynamic trends of direct trade. This apparent 'take-over' scenario actually corresponds to two different cases depending on the level of OPT proportions in total trade.

2.1 high OPT proportions

When OPT proportions used to be very high, the decrease of OPT activity inevitably brought about negative consequences for total exports performances. But what is of particular interest is that decreases of OPT tend to be stronger *precisely* where OPT proportions used to be high. Thus, even extremely high growth rates of direct trade could not offset the decrease of OPT activity.

Table 16. OPT and direct trade (1000 ECU), and OPT proportion in total trade (%), by OPT networks

| | | 91/92 | 92/93 | 93/94 | 94/95 | 91 | 92 | 93 | 94 | 95 | 1991/1995 | | |
|----------|--------|----------|-----------|----------|----------|-----|-----|-----|-----|-----|-----------|------|-------|
| | | opt dir | opt dir | opt dir | opt dir | % | % | % | % | % | opt | dir | total |
| Germ-H | footw. | 27% -11% | -19% 149% | -10% 44% | -32% 99% | 87% | 90% | 75% | 65% | 31% | -55% | 533% | 24% |
| Germ-Pol | footw. | 44% -24% | 5% -16% | -22% 42% | -16% 58% | 40% | 56% | 61% | 47% | 32% | 0% | 44% | 26% |
| Fr-CS | footw. | -9% 32% | 16% 62% | -48% 57% | -45% -2% | 71% | 63% | 55% | 28% | 18% | -70% | 228% | 17% |
| Nl-Pol | edib. | 64% 46% | -39% -14% | -19% 69% | -74% 44% | 66% | 69% | 61% | 43% | 12% | -79% | 206% | 17% |

This is the case of most of the OPT partnerships taking place in the footwear sector (between Germans on the one hand, and Polish and Hungarian firms on the other hand), but also of Franco-Czech partnerships in footwear, and of the OPT relations between Dutch and Polish firms in the sector of edible preparations.

In this case there is no renewed, let alone upgraded, commitment by foreign partners. As foreign partners withdraw from their commitment, local firms are in no position to effectively take over previous OPT activities on their own.

2.2 drastic reductions of OPT proportions

On the contrary, other OPT partnerships correspond more truly to a 'take-over' scenario where absolute decreases of OPT give way to a symmetric increases of 'independent' exports by local firms which account for generally very good performances of total trade.

Table 17. OPT and direct trade (1000 ECU), and OPT proportion in total trade (%), by OPT networks

| | | 91/92 | 92/93 | 93/94 | 94/95 | 91 | 92 | 93 | 94 | 95 | 1991/1995 | | |
|----------|----|----------|----------|---------|-----------|-----|-----|----|----|----|-----------|------|-------|
| | | opt dir | opt dir | opt dir | opt dir | % | % | % | % | % | opt | dir | total |
| Germ-H | 87 | 37% 106% | -61% 6% | 14% 61% | -54% 114% | 30% | 22% | 9% | 7% | 2% | -72% | 657% | 441% |
| Germ-H | 84 | -43% 8% | -29% -2% | 36% 45% | 41% 102% | 14% | 8% | 6% | 5% | 4% | -22% | 208% | 176% |
| Germ-Pol | 84 | -17% -4% | -62% 8% | -5% 28% | 73% 28% | 12% | 11% | 4% | 3% | 4% | -48% | 71% | 57% |

Most notably, this 'take over' scenario concerns almost exclusively OPT partnerships between German and Hungarian firms: in the automotive industry and in the sector of mechanical machinery (there is also, to a lesser extent the case of Germano-Polish partnerships in this latter sector even if direct trade does not show convincing signs of dynamism). Even if it starts from lower levels than the 1st sub-category, the reduction of OPT proportions is extremely important (e.g., from 30% to no more than 5%).

Direct trade is so dynamic as to compensate for a decrease of OPT. Decreasing OPT figures correspond to the actual withdrawal of foreign OPT partners (because trade barriers are being lifted, and because of wage increases). It is a 'normal', and 'favourable' outcome: local firms could take advantage of their partnerships to strengthen their competitiveness, and made it possible to take over OPT production on their own in the best of the worlds... Alternatively, opt partners actually stayed and are still responsible for (part of) the dynamism of direct trade.

Stylised facts

The above patterns are further synthesised in order to pave the way for the subsequent identification of some of their explanatory factors.

Sector variations: T&C vs the other sectors

The above categorisation of OPT networks according to their evolution confirms a very strong sector-specific feature in the case of T&C. In each OPT networks, the trends registered suggest that foreign partners are still present in the OPT business with local firms, irrespective of the nationality of the firms concerned. On the face of it, the other sectors are characterised by very differentiated evolutions which depend on the partner countries.

Evidence of up-grading in some OPT networks

The trajectories of German OPT networks in the Czech and Hungarian electrical machinery sectors are characterised by two traits: increasing OPT transactions, and an outstanding growth of direct -untied- exports (especially in the former Czechoslovakia, and to a lower extent in Hungary). As a result, OPT proportions in total exports to the EU decreased (faster in Hungary than in the former Czechoslovakia). However, OPT proportions register a respectable figure of approximately 20%.

German OPT in the Polish furniture and in the Czech mechanical machinery sectors developed in a similar context (see Table 15).

These trends are particularly striking because decreasing tariff are no longer an incentive. The fact that OPT transactions remain high while direct trade follows extremely dynamic trends is quite encouraging. Indeed, it means that foreign partners are, under one form or another still present and that their prolonged presence is not detrimental to the development of independent exports; possibly it even plays an active role in promoting local capabilities.

Country variations: Germano-Hungarian vs Germano-Czech OPT partnerships

The above tables highlight consistent patterns of country variations. In broad terms, German OPT activity in Hungary shows clear signs of decrease. By contrast, OPT networks involving firms from Germany and the former Czechoslovakia are characterised by a more resilient tendency to decrease, when they do not register frankly positive trends. What is more, as suggested above, they concern a wide array of sectors, and in a limited number of cases, the trajectories of German OPT networks in the former Czechoslovakia correspond to the consolidation of OPT partnerships.

The contrast between the trajectories of German OPT networks in Hungary and in the former Czechoslovakia is best exemplified in the footwear sector. Starting from an appallingly high level of 87% in 1991, the proportion of OPT in total Hungarian exports to the EU was dramatically reduced to slightly more than 30% in 1995. On the face of it, exports from the former Czechoslovakia consist of approximately the same proportion of OPT¹¹⁵ in 1995, but as the result of an opposite evolution (an increase of 518%).

Similarly, in the mechanical machinery and the automotive industry, German OPT networks almost disappear from Hungary, but they keep on playing a role of some importance in the former Czechoslovakia. Whereas in 1995, there is practically no sign of OPT activity left in the Hungarian sector of mechanical machinery, the proportion of OPT in the exports to the EU of the Czechoslovak sector is still above 10%. In the automotive industry, even if OPT has never been truly important neither in the former Czechoslovakia nor in Hungary, it still represents a small share of the exports of the former country to the EU in 1995 (5% of total exports to the EU in 1995, with a peak in 1992 of 16%). In Hungary, instead, the industry developed from scratch without significant contribution of OPT.

The case of several Czech sectors which are the only destination of German OPT activity is more marginal in quantitative absolute terms, but it nevertheless illustrates the strong proclivity of German OPT to engage in the former Czechoslovakia. In the leather and the printing industries, as well as in the sector of edible preparations, not only the proportion of German OPT in total exports to the EU is substantial, but also, it shows a marked propensity to increase.¹¹⁶

¹¹⁵ 27% of exports to Germany and 20% of exports to the EU as a whole.

¹¹⁶ There is also a series of sectors which are strong poles of export dynamism and where Germans undertake some OPT. In these cases, OPT accounts for quite marginal shares, but the latter represent non

Finally, the development of Italian OPT networks in Hungary is consistent with the German patterns. In sectors characterised by poor performances, like footwear and plastics, German firms, who tend to have longer-term time-horizon, withdraw to the benefit of the Italians. In fact, the conclusion of OPT agreements between Italians and Hungarians is a good match as the latter are interested in breaking free from OPT whereas the former are renowned for their footloose and predatory strategies.

Overall, Hungarians seem to do better without OPT, whereas the Czechs have more chance to make the most of their OPT partnerships with German firms. Indeed, the Hungarians are better at taking over OPT and recovering autonomy than their Czech counterparts. In the former Czechoslovakia, instead, the sectors of footwear and to an even higher extent, that of electrical machinery, are characterised by a combination of sound but contained OPT trends with extremely dynamic increases of direct trade. If anything, this shows that German firms stay committed to their local partners while promoting independent¹¹⁷ exports. In other words, German OPT with firms from the former Czechoslovakia in electrical machinery and in footwear are conducive to an apparent consolidation of local capabilities.

These national specificities are not systematically successful, however. The withdrawal of German OPT partners from the Hungarian footwear industry, for example, had devastating effects that strong increases of direct trade could not offset. Conversely, the tendency of Czech firms to clutch at their German partners does not necessarily secure the desired upgraded commitment of the latter. In the leather and printing industries, and especially in the sector of edible preparations, continuing OPT increases without significant growth of direct exports does not augur well of the future.

Direct trade dynamism

An interesting result is that OPT activity in the above OPT networks does not appear to be detrimental to the overall trade performances of local partners. If the evolutions undergone by direct trade are anything to go by, no destruction of local capabilities seem to result from OPT activities. There is, however, one exception which concerns the Germano-Czech partnerships in

negligible amounts of transaction in absolute terms, and they are marked by very dynamic growth rates. These sectors are: plastic, glassware, and iron and steel. Also possibly optical instruments and base metal.
¹¹⁷ The appellation 'independent' should not be misleading ... in fact 'independent' (direct) exports can be attributable to the activities of local firms and/or FOFs. In turn, the latter case can correspond to exports undertaken by previous foreign OPT firms which are still present but have transformed and upgraded their engagement or by greenfield plants.

the sector of edible preparations: direct trade fell dramatically while OPT trade increased strongly reaching outstanding proportions in total trade (around 40% in 1995).

Thus, OPT activities seem to go hand in hand with the strengthening of trade performances and a striking correlation appears between the dynamism of OPT and that of *direct* trade. Comparing OPT networks within a same category shows that OPT is all the more dynamic where direct trade registers the strongest growth rates (or vice versa, direct trade happens to be most dynamic where OPT is also dynamic).

The specific case of the footwear sector

The footwear industry is an excellent illustration of how contrasted the evolutions of EU-CEECs OPT relations can be. Two OPT networks show signs of OPT specialisation: Germano-Czech and Italo-Hungarian partnerships. Instead, Germano-Hungarian and Franco-Czech partnerships testify to the withdrawal of EU partners.

As seen above, German OPT relations with Hungarian partners are traditionally one of the major source of OPT in the sector. Total trade flows in footwear between the two countries are also the most developed. However, between 1991 and 1995, OPT decreased while direct trade increased significantly (+533%) so that the OPT proportion was brought to less than 31% of total trade.

Table 18. OPT in footwear in 1995 (in M ECU, and %), and 1991-1995 evolution (in %)

| | OPT absolute levels | OPT proportion | Direct trade | Total trade |
|-----------------|---------------------|----------------|--------------|---------------|
| Germany-Poland | 23 M (+0%) | 32% (-21%) | 50 M (+44%) | 74 M (+26%) |
| Germany-F. CS | 32 M (+518%) | 27% (+54%) | 85 M (+255%) | 118 M (+302%) |
| Germany-Hungary | 41 M (-55%) | 31% (-64%) | 89 M (+533%) | 130 M (+24%) |
| Italy-Poland | 7 M (+7087%) | 43% (+3273%) | 10 M (+24%) | 17 M (+113%) |
| Italy-Hungary | 19 M (+6004%) | 39% (+1650%) | 28 M (+119%) | 45 M (+249%) |
| Italy- F. CS | 6 M (+167%) | 25% (-33%) | 17 M (+379%) | 23 M (+299%) |
| France-Poland | 0.1M (-93%) | 7% (-91%) | 2 M (+205%) | 2 M (-29%) |
| France- F. CS | 1 M (-89%) | 7% (-91%) | 19 M (+274%) | 20 M (+17%) |
| France-Hungary | 0.5 M (-95%) | 30% (-66%) | 1 M (+7%) | 1.5 M (-85%) |

Radically contrasted evolutions were registered in other cases. Most notably, Italian OPT in Hungary (and, with lower absolute levels involved, in Poland) increased strongly and much faster than direct trade, as well as German OPT activities in the former CS. Whereas the former

OPT bilateral relations are conspicuous for their dynamism, the latter have a strong quantitative significance. But in both cases, OPT in the sector is a new business (i.e., that it is characterised by relatively low starting levels in 1991), and in both cases, OPT came to account for an important proportion in total trade (especially in the bilateral relations between Italy and Hungary: almost 40%, compared to the 27% of the Germano-Czech partnerships). Overall, OPT contributed quite significantly to the growth of total trade in the sector. Thus, rather than upgrading or recovering autonomy, what is at stake is local partners' increased dependence on OPT.

It is interesting to note the perfectly symmetrical evolutions of German and Italian OPT patterns in Hungary and Poland, respectively: the former decrease in both countries, while the latter increase strongly. Overall, OPT in the Polish sector is 'motor', whereas direct trade takes over in Hungary.

Table 19. OPT with EU12 in footwear in 1995 (in M ECU, and %), and 1991-1995 evolution (in %)

| | OPT absolute levels | OPT proportion | Direct trade | Total trade |
|---------|---------------------|----------------|---------------|---------------|
| Poland | 41 M (+31%) | 32% (+13%) | 86 M (+11%) | 127 M (+16%) |
| F. CS | 42 M (+103%) | 20% (-26%) | 171 M (+200%) | 213 M (+174%) |
| Hungary | 61 M (-40%) | 34% (-56%) | 119 M (+294%) | 180 M (+37%) |

3. Evidence from fieldwork

The objective of the present section is to try to lift the indeterminacy proper to a statistical analysis by focusing the analysis at the level of the firm. On the basis of the results of a fieldwork (see Annex 3), it categorises local firms according to the nature of the evolution of their OPT partnerships. The objective is to identify the respective firms' profiles which are most conducive to either the upgrading or the take-over scenario.



Four categories of local OPT firms

1. Whether big or specialised: healthy and dependent.

Examples of firms belonging to this first category are given by *OP* (Prostejov, Moravia), and *Styl* (Szombathely, Hungary). They are two big firms in the T&C sector (5000 and 2100 employees, respectively), privatised in the immediate aftermath of the 'revolution', which produce mainly men's suits and women's ready to wear dresses. OPT proportion is high: 90% for Styl, 50% for OP (3/4 of its exports). Both firms have a privileged relation with one of their OPT partners: *Hugo Boss* for OP, and *Baumler* for Styl. The latter has invested in Styl and holds the majority of its shares. Confidence in the future is the main feature characterising the position of both management staffs; none of them stresses the necessity to reduce the share of OPT in their production. OP, however, is at least in principle, more inclined to develop its own exports. Styl is very positive about OPT and intends to keep up with this situation as they do not fear competition wherever it comes from (be it from Asia, Romania, or the former Soviet states). Interestingly enough, in both firms the average salary is slightly higher than the average of the sector; more to that, the average salary on the respective production lines of H. Boss and Baumler is higher than the average at the level of the firm taken as a whole. It worth noting that Styl as opposed to OP, was engaged in OPT with Baumler before the demise of the COMECON (in a approximately the same proportion: 85 vs. 15%). Instead, OP was entirely geared to Russia, and started OPT in 1989.

In the electrical machinery sector an example of firms undertaking this first type of OPT is given by *CKD-Elektrotechnika* (1000 employees). CKD-Elektrotechnika is mainly oriented to the local Czech market (90% of local sales, and 10% of exports¹¹⁸); however, 40% of CKD-Elektrotechnika's exports are ascribable to one OPT agreement with a German partner (*SFM*, a producer of medical equipment). OPT activities are undertaken in a special workshop making needles. It is physically isolated from the rest of the divisions, and employs 100 workers: 100% of the input comes from their German partner, and 100% of the output is exported back to them. Although it would be incorrect to consider CKD-Elektrotechnika as a whole to be dependent on OPT, SFM is nevertheless in a position of full control of the activities undertaken within the workshop; in this sense, there is quasi-integration between SFM and one part of CKD-Elektrotechnika. An important premise for understanding the nature of the relations between the two partners, is that CKD-Elektrotechnika had to invest significantly in a climatisation system

¹¹⁸The proportion becomes 70% vs 30% if CKD's sales to Czech firms (such as Skoda) which are then exported by the latter are considered as (indirect) exports.

(in order to sterilise the air) which is a condition sine-qua-non for undertaking the kind of tasks required by the OPT agreement. Another interesting feature of the agreement has to do with the apparently very long term time horizon of the co-operation. Besides the fact that the Czech managing staff refers to a minimum period of 10 years, SFM has invested in a greenfield company established in the Czech Republic (*SeFeMed*) which deals exclusively with the OPT relations between CKD and SFM. In addition, the OPT contract contains certain guarantees for the Czech partner such as the obligation for SFM to notify 6 months before their intention to lower orders whenever they decide to do so, and to inform their Czech partner 5 years before they decide to stop the co-operation completely. Reciprocally, the contract contains a clause stipulating that wages should increase according to inflation (i.e., around 10% a year). Finally, it is worth noting that there is no chance for CKD to take over the production on its own as the distribution of the concerned products in Western Europe is completely controlled by a Belgian firm in a monopoly position. The managers added that they are very satisfied with the profit conditions (which are also stipulated in the contract).

Another case of long-lasting OPT relations, also in the electrical machinery sector, is given by the example of *ABB Elektro-Praga*. OPT with one partner which is also the main investor (ABB) forms a large part of ABB Elektro-Praga's exports; products concerned are wall electric switches. What is particularly interesting in this case is that avoiding tariff duties was openly an important element in the decision to undertake OPT. Whereas it is agreed that wage rises can represent a real danger, it is to be stressed that ABB Elektro-Praga is investing in order to increase productivity faster than wages will rise. The future of the co-operation is rather dependent on prospects on the market for the concerned product.

2. *Striving for disentanglement*

Timo, a Czech producer of underwear with 800 employees is an example of a firm belonging to a second category which managed successfully to take over production on its own. Split from *Triola* in 1992, one of the biggest T&C firm under communist times (20 000 employees), it kept the OPT relation *Triola* was having with the German *Felina*. Decision was taken to rely on OPT for no more than 30% of total production. And so it was and the proportion decreased to 10-12%. The staff stresses how important OPT proved to be for getting to know the latest developments in fashion and getting acquainted with the most sophisticated techniques; but it was also extremely valuable for short term advantages: not having to pay for the material, and getting the proceeds immediately was very helpful. However, the profitability associated with independent exports is higher than with OPT.

In the electrical sector, the Hungarian firm *Vilati* occupies a somewhat controversial position: somewhere between the steady situation of the previous category, and the more risky status of the present one. The firm is a state-owned company with 480 employees producing process control systems, printed circuit boards, electrical and electronic equipment ... Up to 90% of the total production is made for about 10 OPT partners; however, one of them (*Brunswick Bowling*) accounts for 50% of the total OPT contracts. The manager distinguishes between 3 sorts of partners: 1) the long term ones, necessary to give a long term horizon to the firm's strategy (in order to invest), account for 80% of the total number of partners; 2) the occasional partners represent around 20% of the total number; 3) the potential ones which are very important in order to keep contact with the demand, and to promote *Vilati's* capabilities. None of them however is going to acquire a share when the firm will be privatised. The main reason advanced for *Vilati's* dependence on OPT is the price of inputs. As a matter of fact, inputs have to be imported, meaning that foreign firms are almost always in a more favourable position in this respect. Moreover, to the price of imported input must be added transport costs, and tariff duties. Finally, to undertake independent exports the firm would have to pay other tariff duties on the way to European markets (in conformity with the rules of origin legislation). *Vilati* has definitely not enough capital to advance in order to cover such expenses. As a result, the choice between independent exports and OPT does not really exist. About the foreseeable future, a realistic position prevails: it would be good to increase the proportion of independent exports ... however, it is safer to focus on keeping up with the technological pace in order to keep on presenting an attractive profile for OPT partners.

Fekon, a Hungarian state-owned clothing firm specialised in shirts (1200 employees) is clearly in a much more uncertain position; it depends on OPT for 90% of its production with 12 different partners. Although the staff is well aware of the necessity to take over the production on their own (they mention a time-horizon for OPT in the sector limited to 5 years), they admit that they are not in a position to do so at the moment. What they long for is an injection of capital in order to make the necessary investments, and change their product line. Interestingly enough none of the actual OPT partners mentioned their intention to acquire a stake in *Fekon* when it will be privatised.

3. Starving for OPT

The state-owned enterprise *Tos Hostivar*, manufacturer of grinding machines, with 550 employees¹⁹ stresses how valuable OPT is. OPT co-operation accounts for 30% of the total

¹⁹ A sharp reduction of the workforce: from 1250 in 1991, to 300 is due to take place.

production (the other 70% are exported under their own brand). Tos have 5-6 partners. One of them, a German firm, has established a separate workshop in Tos's hall where German supervisors work hand in hand with Czech (or Ukrainian!) workers to produce post office printing machines. The Germans are settled for '10 years' according to Tos's manager; moreover, they will start to source locally. Tos is willing to increase OPT even if it is acknowledged that such form of co-operation in general has a lifetime of only 5 years. OPT is considered to be valuable in that it occupies production capacities, bring in more updated techniques, and makes market mechanisms familiar.

Two clearly negative experiences are illustrated by two firms based in Prague that used to export massively to the Soviet markets: *Tesla Karlin* (electrical equipment, 1000 employees) and *CKD Tatra* (heavy transport equipment, 1100 employees). The main matter for grievance concerns the end of the OPT co-operation that both firms had with a foreign partner (*Siemens* and *AEG Westinghouse*, respectively). Siemens's engagement in an OPT co-operation with Tesla Karlin took place in a wider context: co-operation between the two partners started with Tesla Karlin producing under Siemens's license. Subsequently, Siemens provided Tesla Karlin with a new machine in exchange for an OPT contract (for a value amounting to 15% of the total turnover of Tesla Karlin): it was probably a means for Siemens to test Tesla for potential future co-operation (thus leading to the first type of OPT relations). However, Siemens was not satisfied and decided to shorten the initial repayment schedule of 4 years down to two years putting considerable pressure to bear upon their partner. No other co-operation was on the agenda. Tesla Karlin is now looking for other partners; they already had some sporadic OPT co-operations on a much lower scale (less than 1% of the turnover), but these were just temporary contacts; probably the foreigners had in mind to explore the Czech market rather than to do serious OPT. Similarly, it was the premature withdrawal of AEG Westinghouse that caused the disillusion of CKD Tatra about OPT. In theory, CKD Tatra does not undertake OPT as they source locally. However, they concluded such a contract as a first step towards more thorough co-operation with AEG Westinghouse; the formation of a Joint Venture was contemplated. The contract amounted to 100 millions Kcs, but the value of the OPT actually performed was only 70 to 80% of that sum. In mid-95 it was decided that the agreement would not be renewed; contracts were transferred to another firm of the same holding (CKD-Lokomotivka). Tatra maintains that they benefited from this co-operation in terms of training, and technological upgrading ... they would 'desperately' look for other OPT partners, but they are very disappointed that there are so few of them.

4. Careless

Pal (4000 employees), and *Ateso* (3100 employees) are two Czech firms in the automobile industry which carry out some OPT on a marginal basis. The less involved is *Ateso*, which main raison d'être is to supply *Škoda*, and which buy locally 90% of its input. However, *Ateso* does some OPT in one of its plant with its Joint Venture partner (*Lucas*). The products concerned are brake wheel cylinders. *Pal* is doing more OPT, but it is still a marginal activity (3% of the total output, and 15% of the exports). Its main activity also consists in supplying *Škoda* (85% of total production, the rest is exported). They would like to increase their level of OPT, and think that the time-horizon of such activities is of about 10 years: indeed, what matters is not only the convenient wage level, it is also the low transport costs. Apparently both firms are satisfied with the profit margins associated with OPT.

Four types of OPT partnerships, and possible trajectories

The first case concerns local firms which are dependent on OPT to a high extent (going up to 90% of their total production), and which have one main partner, accounting for the vast majority of OPT contracts. The foreign partner is committed on a long term basis; if it persists, it can "invest" time and effort (even machines) in order to bring the level of quality up to his own standard. Thus, one positive feature (the long term commitment of the foreign partner) compensates for the negative effects (the dependence on OPT). Possibly, the relation can develop into foreign direct investment, and OPT and FDI can take place simultaneously. In this first category, OPT and FDI are therefore complementary. It is worth noting that in this first category trade restrictions (either quotas or tariff barriers) rendered the access to EU markets impossible without OPT. This situation is characteristic of OP and Styl, but also of CKD Elektrotechnika. Some hypotheses as to the foreseeable future of such firms can be formulated. A relatively safe bet is that foreign partners are not likely to withdraw suddenly on the mere basis of wage increases. As suggested, foreign partners can increase the stake they already have in these firms, and even invest capital. If they do not do so, local firms can anyway take advantage of their close OPT relationship, and "specialise" in the OPT business.

The second category of OPT relations concerns local firms that are significantly dependent on OPT, not with one main partner, but with several of them. Clearly, such firms are in a more uncertain situation. Although diversifying the number of partners might be a way to reduce the risk incurred in case one of them retracts, it is no answer to a collective withdrawal. The problem is that the very fact that partners are numerous would tend to indicate that the latter

have short term views as they are not in a position to hold sway; chances for them to retreat collectively as soon as wage levels become dissuasive are therefore higher.

This is sharp contrast with the first category of OPT-relations. Such situation corresponds to the case of 'smaller' firms in the T&C sector (Timo, and ONA), as well as firms in the machinery sector which have to face a restructuring process. Indeed, as opposed to the T&C industry, achieving the quality standard that would allow to compete on the world markets in the machinery sector, often requires deeper and more thorough transformation of the production facilities that were once sufficient for exporting to the East (Tos is a good example of the huge effort to be undertaken in this respect). In these cases, the main objective of the foreign partners, which are most often medium-sized enterprises, is to take advantage of low labour costs for the time being, without getting enmeshed in a more thorough co-operation¹²⁰; OPT is for them an advantageous substitute for foreign direct investment

The question at stake for the local firms has therefore to do with their chance to take over production on their own. In this respect, there is no predictable issue: it is up to each individual firm to seize the opportunity given to them by their OPT co-operation i.e., getting in contact with know-how, new technologies ... while benefiting from a period of respite (e.g. Vuoso which is actually doing quite well in reducing its dependence on OPT; conversely Fekon, in the shirt sector, faces quite a difficult situation as it is highly dependent on quite volatile partners). One factor that may hamper the desired upgrading of the local firms' capabilities is the potentially bad conditions of profitability attached to OPT. If the OPT business does not give the means for investing, then the life-span of the local firm is limited to the duration of the co-operation (which is very much the case of Fekon).

In the third category, firms are in worse position than the previous group, not so much as a result of OPT, but rather because of a *lack* of OPT. In their case, OPT does not account for a large proportion of their total production, even though it can contribute more than marginally to total income; the number of OPT partners is relatively small. A priori, they are the same firms than the candidates for the previous group, except that the extent of the problem they face is wider. For these firms, productivity consideration offset the gains from lower labour costs. In other terms, far from presenting a competitive advantage, they are characterised by some disadvantage so that even under the very favourable terms that OPT grants to potential foreign partners, the latter engage in OPT only very reluctantly. If by chance, local firms manage to get some contracts, it is for relatively small amount of money, and on a very short term basis. These firms cannot afford paying attention to the negative aspects of OPT, and look desperately for how to increase their contacts (two typical cases are given by CKE Tatra, and Tesla Karlin).

¹²⁰It can be also the case that foreign firms engage in OPT on a short term basis in order to get acquainted with the local market and firms.

Finally, the last group of firms displays only low levels of dependence on OPT for the simple reason that OPT is not of crucial importance for them. This is so, for example, because they gear the majority of their production to the local markets, or because local supply is very competitive. It is firms in this group that enjoys the best bargaining position vis-à-vis their foreign partners, they can potentially draw the benefits associated with OPT without incurring any risk. In the automobile sector, for example, local firms are very often suppliers of the Škoda plant of VW, dedicating the majority of their production capacities to this activity (e.g. Pal, and Ateso). However, equally often, the rest of the production is done on an OPT basis for clients abroad.

Overall, the result of the fieldwork shows that the outcome of an OPT partnership can be astonishingly varied depending on the sector, the respective nationality of the OPT partners, and other firm-level features like the possession of a competitive advantage or the size of the local firms. However, those local firms which are most likely to secure the relative long term commitment of their foreign partners tend to be big and mainly to belong to the T&C sector.

Let a rough conclusion be formulated under the form of what might, in a first approach, resemble a paradox: dependence on OPT may, under certain circumstances, be the best way for securing the positive aspects of OPT. In other terms, better to be highly dependent on a stable foreign partner, than to resort to OPT on a lower scale, but with very volatile partners. Overall, the OPT example shows how important it is to determine where and by whom bargaining power is exercised in the value added chain.¹²¹

4. Patterns and explanations

On the basis of the evidence made available by statistics and fieldwork, it is possible propose some explanatory factors to account for the distinct patterns of OPT developing between the EU and CEECs.

¹²¹ This result is particularly interesting in the light of development concerning the notion of 'commodity chains' (Gereffi, 1994). See Chapter 6.

Evidence on durable and up-graded partnerships in the Textile and Clothing sector, and in some OPT networks.

The extremely dynamic and continuing increases of OPT absolute *and* relative levels in the T&C sector testify to the continuing presence of foreign partners and to their renewed commitment under the form of OPT partnerships. As suggested above, local firms make a strong use of the arrangement in order to avoid restrictive quota imposed on direct trade. Thus, the relative state of dependence on OPT in which local firms are placed if they want to access the EU markets, enables foreign partners to extend control over the latter without necessarily disbursing capital.

In some circumstances, foreign partners take advantage of the arrangement in order to rationalise their strategies on the regional scale. OPT enables them to apply Just In Time and lean production methods. In these cases, they contribute to the strengthening of the technological capabilities of local firms in a substantial way.

The fieldwork study also showed that foreign partners falling into this category are often big firms which are committed to their local counterpart over a significant time-span. Such relationships involve a privileged couple, at the expense of a strategy of diversification of foreign partners.

Overall, the convergence of interest between local and foreign firms spurs relatively durable and complex forms of co-operation between local and foreign firms. This result tends to belie a scenario of a wave of re-relocations to a second groups of countries on the fringe of the CEECs. In fact, even if such 're-relocations' take place, the present evidence shows that they are more than compensated by increased OPT commitments of EU firms in the 1st-wave of CEECs countries.

Also, fieldwork suggested several cases of durable partnerships in the electrical machinery sector between German firms on the one hand, and Czech and Hungarian partners on the other hand. This feature was confirmed by statistical evidence, even if in a different fashion than in the T&C case. This is all the more interesting if account is taken of the significant German direct investments precisely in these sectors.

These evidences tend to speak in favour of the prolonged and upgraded commitment of foreign partners. In fact, most likely, these OPT networks correspond at the same time to another category of OPT, that of cross-border transactions engaged by German SMEs on the basis of motives such as labour costs and proximity (see below).

Cross-border co-operation between German and Czech partners

A plausible explanation for the opposite trends characterising certain German OPT networks in Hungary and in the former Czechoslovakia is that they are ascribable to the strategies of smaller firms which do not necessarily aim at a rationalisation of their activities on the regional scale, but simply at taking advantage of favourable costs. With the main objective of easing the constraint represented by high domestic labour costs, German firms thus take advantage of the arrangement to relocate part of their production to their immediate neighbours. They use OPT as a strategy of crisis management and fall back on production in their immediate spatial proximity.

They first went to Hungary where the process of liberalisation started earlier. When the former Czechoslovakia opened up its markets as well, they reoriented their activities away from Hungary to the Czech Republic, which is much closer than Hungary, and which industrial traditions present a serious advantage compared to Poland.

Geographical and cultural proximity appears to play a crucial role. Reduced transport costs, shorter delays, and the possibility to supervise the development of OPT co-operation in location are important factors accounting for the diversification and the dynamism of German OPT activities in the former Czechoslovakia.

The commencement of the opening up process is also an important factor. It is indeed striking to note that the sharpest decreases of German OPT were registered in Hungary in sectors already significantly dependent on OPT in 1991. The very same sectors in the former Czechoslovakia were at that time only marginally touched, but they subsequently followed a strong catching up process. The example of the footwear sector is a straightforward example.

Possibly, the chronological starting point of OPT relations is also a factor influencing the time-horizon of German partners. Those who started their operations under Communist times were acting in a environment particularly uncertain and were thus likely to be initially driven by relatively short-term strategic considerations. For this reason, Hungary tended to attract comparatively more of such 'volatile' OPT partners. In the Czech Republic, instead, more committed latecomers could contemplate longer-term strategies already at the start of OPT partnerships. For this reason, the OPT strategies of German SMEs in the former Czechoslovakia, even though they are very akin to 'workbench' activities, are not necessarily characterised by short-term time-horizon.

Finally, besides proximity and the chronological date of the commencement of OPT partnerships, the industrial structures inherited from the past, and the present performances of the sectors concerned are also intervening variables. In this respect, Polish and Hungarian firms have some disadvantages compared to their Czech counterparts. In Hungary, for example, the national

debt burden and the government strategy aiming at full repayment has been an additional constraint making more difficult the restructuring and modernisation of local firms necessary to secure the prolonged commitment of their foreign partners. What is more, Polish and Hungarian firms do not benefit from an industrial history and reputation to the same extent as Czech firms.

Thus, rather ironically, the 're-relocation' of German OPT activities is not so much geared further East, where wage increases are lagging; they rather follow an 'inbound' wave, away from Hungary back to the Czech Republic.

It is also very important to note that the withdrawal of German OPT partners from their engagement in Hungary gives apparently way to a 'take-over' scenario as testified by the very dynamic trends of direct trade. Fieldwork also made clear a higher awareness of Hungarian firms as to the many drawbacks of the arrangement, and their higher degree of preparation in the case of their partners' withdrawal.

All in all, OPT did not appear to be detrimental to local capabilities. In the former Czechoslovakia, OPT tends to give way to the consolidation of partnerships between local and foreign firms. In Hungary, instead, local firms are relatively successful at taking over OPT activities on an independent basis.

3.3 Conclusion

There are some general traits characterising the very differentiated trajectories followed by OPT networks. Most importantly, OPT does not seem to be detrimental to the trade performance of single OPT networks. In most cases, either because total trade is inflated by very dynamic OPT evolutions, or because direct trade takes over OPT trade, the general performances are often quite impressive precisely in the sectors concerned by OPT. Overall, OPT played a primary role in the reorientation of CEEC trade to Western markets.

But it is the extreme diversification of the OPT patterns developing in East-West relations which is most striking. These different patterns follow different evolutions with very distinct qualitative contributions to the terms of the regional economic integration. In a few cases, OPT seems to be the basis for further sounder co-operation between local and foreign firms. This is mainly so in textile and clothing where Western firms appear to rationalise their strategies at the regional scale on the basis of OPT partnerships. A consolidation of OPT partnerships is also possible in some other cases: mainly in the sector of electrical and mechanical machinery between German and Czech partners, possibly furniture in Poland.

Otherwise, in other sectors, the potentials for the establishment of a regional division of labour on the basis of OPT are not really grasped by Western firms. Only German firms, possibly small and medium sized enterprises hit by high domestic labour costs, appear to take advantage of the arrangement. They use OPT to carry out 'workbench' activities mainly in the former Czechoslovakia, and at the expense of an earlier engagement in Hungary.

Annex 1 Budget sheet of a Czech OPT firm in the Textile and Clothing sector

Table 1. Monthly, in Kcs, 1994.

| | |
|------------------------------|----------------|
| A. Fixed costs | |
| -rent (180 sq m) | 30 000 |
| -office | 6 000 |
| -heating/electricity | 7 000 |
| -provision for depreciation: | |
| *electric system | 5 000 |
| *machines | 5 000 |
| -miscellaneous | 3 000 |
| Total | 56 000 |
| B. Management costs | |
| -manager | 20 000 |
| -executive assistant | 15 000 |
| -accountant | 15 000 |
| -secretary | 6 000 |
| -taxes etc | 1 000 |
| -cleaning | 6 000 |
| Total | 63 700 |
| C. Workforce | |
| -14 dressmakers (x4000) | 56 000 |
| -4 skilled " (x 6000) | 24 000 |
| -1 foreman | 10 000 |
| -1 instructor | 10 000 |
| -social/health care (35%) | 35 000 |
| Total | 135 000 |
| D. TOTAL | 254 000 |

One can assume that running a medium size business in the Czech clothing industry involves an overall monthly cost of approximately 254,000 Kcs [Table 1]. The working potential of 18 dressmakers is 198,720 min/months¹²². If they were paid 21 Pfennigs/min the potential revenue of the Czech OPT firm would be 41731 DM, i.e., 713,186 Kcs¹²³. It means that the Czech OPT firm would enjoy a gross profit of 180% ... This is not, however, the real outcome of the business. Czech physical productivity lags behind EU standards by approximately 50 to 60%. If one considers that Czech productivity is half the German level, the potential revenues shrink to 356,593 Kcs, and the gross profit rate to approximately 40%. Now, if a risk factor is taken into account (absenteeism, rejected quality etc), as well as extra costs such as deposits of VAT and tariffs, the potential revenues have to be discounted by a factor greater than one (e.g., 1.2). The expected profit rate would then decrease to 17% (the expected gross revenues decrease to 297,161 Kcs). This demonstrates that OPT operations still present some potentialities in terms of profit for Czech firms, even if the margin is narrow.¹²⁴

¹²²I.e., 18 x 23 x 8 x 60. There are 23 working days a month, and 8 hours a day.

¹²³With an exchange rate of 17.09 Kcs/DM.

¹²⁴This is particularly true if one takes into account the actual average levels of profitability of the Czech clothing industry measured as gross profits relative to full cost (see Benacek, Mejstrik, 1994):

| | | | |
|---------------|-------|------|------|
| | 1990 | 1991 | 1992 |
| Clothing ind. | 12,1% | 9,9% | 7,9% |

Let us consider what might be the wage increase which would wipe out the expected profit to zero in the above illustrative example.¹²⁵ The average wage (including taxes and insurance) per person was 7920 Kcs/month (in Fig. 1, the sum of section B and C is 198,000 Kcs).¹²⁶ The zero profit hypothesis is valid if the wage bill rises to 241,161 Kcs. Total costs would then amount to 297,161Kcs (including fixed costs for an amount of 56,000 Kcs). This would be the effect of a 21.7% wage inflation, provided that productivity is constant.

Such an increase of the wage level is possible, if not likely, in the Czech T&C sector. Indeed, in the past two years, wages have been rising fast in the manufacturing sector (in 1992-1993, the increase rate was 49%). Moreover, there is a gap between wages in manufacturing and clothing industries that cannot be but somehow filled (the latter were by 31.5% lower than the former at the end of 1993). Two factors could offset its detrimental effects on the OPT business: the future of OPT is strictly conditioned either by rises in productivity or by increased revenues per minute (this latter factor depending on the competition from other East European countries).

¹²⁵For the purpose of simplicity, the present analysis takes place in a static framework. It should however be kept in mind that what actually matters is not the *absolute* wage differential, but the *relative* wage differential.

¹²⁶In the last quarter of 1993, the actual average wages in the textile sector was 6143 Kc/month and 5954 Kc/month in the clothing sector (see Benacek, Mejstrik, 1994).

Annex 2 Trajectories of bilateral OPT relations between 1991 and 1995, by sector

Textile and Clothing

| | Germany | Netherlands | Italy | France | Denmark | EU12 |
|-----------|---|---|---|---|---|--|
| Poland | -OPT absolute level in 1995: 1 bn +120 % 91/95 -opt dependence in 1995: 87% + 4 % 91/95 | -OPT absolute level in 1995: 156 M + 263 % 91/95 -OPT dependence in 1995: 90% + 22 % 91/95 | -OPT absolute level in 1995: 22 M + 421 % 91/95 -OPT dependence in 1995: 41% + 229 % 91/95 | -OPT ab. level in 1995: 71 M + 94 % 91/95 -OPT dependence in 1995: 70% + 28% | -OPT abs. level in 1995: 150 M + 142 % 91/95 -OPT dependence in 1995: 90% + 10 % 91/95 | -OPT absolute level in 1995: 1.5 bn + 133 % 91/95 -OPT dependence in 1995: 81% + 10 % 91/95 |
| Former CS | -OPT absolute level in 1995: 457 M + 285 % 91/95 -OPT dependence in 1995: 63% + 57 % 91/95 | -OPT absolute level in 1995: 35 M + 106 % 91/95 -OPT dependence in 1995: 53% + 17 % 91/95 | -OPT absolute level in 1995: 33 M + 653 % 91/95 -OPT dependence in 1995: 23% + 108 % 91/95 | -OPT abs. level in 1995: 26 M + 554% -OPT dependence in 1995: 43% + 246 % 91/95 | -OPT abs. level in 1995: 2 M | -OPT absolute level in 1995: 571 M + 275 % 91/95 -OPT dependence in 1995: 51% + 61 % 91/95 |
| Hungary | -OPT absolute level in 1995: 333 M + 28 % 91/95 -OPT dependence in 1995: 78% + 1 % 91/95 | -OPT absolute level in 1995: 58 M + 49 % 91/95 -OPT dependence in 1995: 89% 0 evolution | -OPT absolute level in 1995: 89 M + 309 % 91/95 -OPT dependence in 1995: 72% + 84 % 91/95 | -OPT abs. level in 1995: 62 M + 59 % 91/95 -OPT dependence in 1995: 82% + 14 % 91/95 | -OPT abs. level in 1995: 3.5 M | -OPT absolute level in 1995: 588 M + 50 % 91/95 -OPT dependence in 1995: 75% + 6 % 91/95 |
| CEEC4 | -OPT absolute level in 1991: 857 M -OPT absolute level in 1995: 1.8 bn | -OPT absolute level in 1991: 99 M -OPT absolute level in 1995: 250 M | -OPT absolute level in 1991: 30 M -OPT absolute level in 1995: 143 M | -OPT abs. level in 1991: 80 M -OPT abs. level in 1995: 159 M | -OPT abs. level in 1991: 65 M -OPT abs. level in 1995: 170 M | -OPT abs. level (1995): 2.6 bn +123 % 91/95 -OPT dependence (1995): 71% +14 % 91/95 |

Electrical Machinery

| | Germany | Netherlands | Italy | France | Belg-Lux | EU12 |
|-----------|--|---|---|--|--|--|
| Poland | -OPT absolute level in 1995: 61 M + 328 % 91/95 -opt dependence in 1995: 16 % -6 % 95 | -OPT absolute level in 1995: 5 M + 93 % 91/95 | | -OPT abs. level in 1995: 5 M +1122 % 91/95 -OPT dependence in 1995: 9 % | | -OPT absolute level in 1995: 72 M + 313 % 91/95 -OPT dependence in 1995: 10 % 0 evolution |
| Former CS | -OPT absolute level in 1995: 189 M + 461 % 91/95 -OPT dependence in 1995: 23 % - 39 % 91/95 | -OPT absolute level in 1995: 6 M | | -OPT abs. level in 1995: 4 M + 420 % 91/95 -OPT dependence in 1995: 9 % % 91/95 | | -OPT absolute level in 1995: 201 M + 482 % 91/95 -OPT dependence in 1995: 20 % - 13 % 91/95 |
| Hungary | -OPT absolute level in 1995: 112 M + 90 % 91/95 -OPT dependence in 1995: 19 % - 46 % 91/95 | -OPT absolute level in 1995: 4 M | -OPT absolute level in 1995: 4 M + 506 % 91/95 -OPT dependence in 1995: 7 % | | -OPT absolute level in 1995: 14 M -OPT dependence in 1995: 51 % | -OPT absolute level in 1995: 136 M + 119 % 91/95 -OPT dependence in 1995: 15 % - 44 % 91/95 |
| CEEC4 | -OPT absolute level in 1991: 106 M -OPT absolute level in 1995: 361 M | -OPT absolute level in 1991: 5 M -OPT absolute level in 1995: 15 M | -OPT absolute level in 1991: 0.6 M -OPT absolute level in 1995: 4 M | -OPT absolute level in 1991: 11 M -OPT abs. level in 1995: 16 M | -OPT absolute level in 1991: - -OPT abs. level in 1995: 16 M | -OPT abs. level (1995): 410 M + 258 % 91/95 -OPT dependence (1995): 16% - 25 % 91/95 |

Footwear

| | Germany | Netherlands | Italy | France | Denmark | EU12 |
|--------------|---|--|--|---|---|--|
| Poland | -OPT absolute level in 1995: 23 M 0 % 91/95 -opt dependence in 1995: 32 % -21 % 91/95 | -OPT absolute level in 1995: M -55 % 91/95 -OPT dependence in 1995: 22 % -49 91/95 | -OPT absolute level in 1995: 7 M + 7087 % 91/95 -OPT dependence in 1995: 43 % +3273 % 91/95 | -OPT absolute level in 1995: 0.2M 3 M in 1991 i.e., -93 % 91/95 -OPT dependence in 1995: 7% 78% in 1991, i.e., -91 % 91/95 | -OPT absolute level in 1995: 9 M -OPT dependence in 1995: 92 % | -OPT absolute level in 1995: 41 M + 31 % 91/95 -OPT dependence in 1995: 32 % + 13 % 91/95 |
| Former CS | -OPT absolute level in 1995: 32 M + 518 % 91/95 -OPT dependence in 1995: 27 % + 54 % 91/95 | | -OPT absolute level in 1995: 6 M + 167 % 91/95 -OPT dependence in 1995: 10 % -74 % 91/95 | -OPT absolute level in 1995: 4 M -70 % -OPT dependence in 1995: 18 % -74 % 91/95 | | -OPT absolute level in 1995: 42 M + 103 % 91/95 -OPT dependence in 1995: 20 % -26 % 91/95 |
| Hungary | -OPT absolute level in 1995: 41 M -55 % 91/95 -OPT dependence in 1995: 31 % -64 % 91/95 | -OPT absolute level in 1995: M | -OPT absolute level in 1995: 18 M + 6004 % 91/95 -OPT dependence in 1995: 39 % + 1650 % 91/95 | -OPT absolute level in 1995: 0.5 M -95 % 91/95 -OPT dependence in 1995: 31% -66 % 91/95 | | -OPT absolute level in 1995: 61 M -40 % 91/95 -OPT dependence in 1995: 34 % -56 % 91/95 |
| CIEC4 | -OPT absolute level in 1991: 119 M -OPT absolute level in 1995: 96 M | -OPT absolute level in 1991: 3.5 M -OPT absolute level in 1995: 2.2 M | -OPT absolute level in 1991: 2.5 M -OPT absolute level in 1995: 30 M | -OPT absolute level in 1991: 25 M -OPT absolute level in 1995: 4.3 M | -OPT absolute level in 1991: 3 M -OPT abs. level in 1995: 10 M | -OPT abs. level (1995): 144 M -6 % 91/95 -OPT dependence (1995): 28% -43 % 91/95 |

Furniture

| | Germany | Netherlands | EU12 |
|--------------|---|--|--|
| Poland | - OPT absolute level in 1995: 119 M + 93 % 91/95 - opt dependence in 1995: 16 % - 41 % 91/95 | -OPT absolute level in 1995: 2.4 M | -OPT absolute level in 1995: 126 M + 99 % 91/95 -OPT dependence in 1995: 14% - 31 % 91/95 |
| Former CS | -OPT absolute level in 1995: 28 M + 199 % 91/95 -OPT dependence in 1995: 8 % - 27 % 91/95. | | -OPT absolute level in 1995: 28 M |
| Hungary | -OPT absolute level in 1995: 16 M +14 % 91/95 -OPT dependence in 1995: 12 % -21 % 91/95. | | -OPT absolute level in 1995: 16 M |
| CEEC4 | -OPT absolute level in 1991: 85 M -OPT absolute level in 1995: 163 M | -OPT absolute level in 1991: ~ -OPT absolute level in 1995: 2.4 M | -OPT abs. level (1995): 170 M + 95 % 91/95 -OPT dependence (1995):11% - 30 % 91/95 |

Mechanical machinery

| | Germany | Italy | EU12 |
|--------------|---|--|---|
| Poland | - OPT absolute level in 1995: 10 M 20 M in 1991, i.e., - 48 % 91/95 - opt dependence in 1995: 4 % - 67 % 91/95 | -OPT absolute level in 1995: 1.4M + 2651 % 91/95 -OPT dependence in 1995: 3 % | -OPT absolute level in 1995: 13 M - 41 % 91/95 -OPT dependence in 1995: 3% - 66 % 91/95 |
| Former CS | -OPT absolute level in 1995: 89 M + 75 % 91/95 -OPT dependence in 1995: 13 % - 53 % 91/95 | -OPT absolute level in 1995: 2.6M +2597 % 91/95 -OPT dependence in 1995: 4% +1273 % 91/95 | -OPT absolute level in 1995: 93 M + 76 % 91/95 -OPT dependence in 1995: 10% - 43 % 91/95 |
| Hungary | -OPT absolute level in 1995: 23 M - 22 % 91/95 -OPT dependence in 1995: 4 % - 72 % 91/95 | -OPT absolute level in 1995: 1.1M + 138 % 91/95 -OPT dependence in 1995: 3% + 48 % 91/95 | -OPT absolute level in 1995: 25 M - 19 % 91/95 -OPT dependence in 1995: 2% - 78 % 91/95 |
| CEEC4 | -OPT absolute level in 1991: 100 M -OPT absolute level in 1995: 122 M | -OPT absolute level in 1991: 0.6 M -OPT absolute level in 1995: 5 M | -OPT abs. level (1995): 131 M + 23 % 91/95 -OPT dependence (1995):5% - 58 % 91/95 |

Automotive Industry

| | Germany | EU12 |
|-----------|---|--|
| Poland | -OPT absolute level in 1995: 15 M + 48 % 91/95 - opt dependence in 1995: 5 % - 81 % 91/95 | -OPT absolute level in 1995: 16 M |
| Former CS | -OPT absolute level in 1995: 33 M +129 % 91/95 -OPT dependence in 1995: 6 % -28 % 91/95 | -OPT absolute level in 1995: 37 M |
| Hungary | -OPT absolute level in 1995: 4 M ** - 72 % 91/95 -OPT dependence in 1995: 2 % - 95 % 91/95 | -OPT absolute level in 1995: 5.6 M |
| CEEC4 | -OPT absolute level in 1991: 38 M -OPT absolute level in 1995: 51 M | -OPT abs. level (1995): 59 M + 37 % -OPT dependence (1995): 3% - 69 % 91/95 |

Plastics

| | EU12 |
|--|---|
| | -OPT absolute level in 1995: 5 M |
| | -OPT absolute level in 1995: 20 M + 586 % 91/95 -OPT dependence in 1995: 3 % + 146 % 91/95 |
| -OPT absolute level in 1995: 16 M + 244 % 91/95 -OPT dependence in 1995: 17 % + 102 % 91/95 | -OPT absolute level in 1995: 21 M |
| -OPT absolute level in 1991: 5 M -OPT absolute level in 1995: 17 M | -OPT abs. level (1995): 47 M + 278 % 91/95 -OPT dep. (95): 4%, +72 % (95/91) |

Leathers

| | Germany | France | EU12 |
|-----------|--|---|---|
| Poland | - OPT absolute level in 1995: 7 M - 11 % 91/95 - opt dependence in 1995: 11 % -51 % 91/95 | -OPT absolute level in 1995: 1.7 M + 410 % 91/95 -OPT dependence in 1995: 24 % + 319 % | ? |
| Former CS | -OPT absolute level in 1995: 14 M +176 % 91/95 -OPT dependence in 1995: 26 % +20 % 91/95 | | -OPT absolute level in 1995: 18 M + 208 % 91/95 -OPT dependence in 1995: 17 % + 48 % 91/95 |
| Hungary | -OPT absolute level in 1995: 8 M - 23 % 91/95 -OPT dependence in 1995: 22 % - 34 % 91/95 | -OPT absolute level in 1995: 1 M | -OPT absolute level in 1995: 10 M - 48 % 91/95 -OPT dependence in 1995: 14% - 53 % 91/95 |
| CEEC4 | -OPT absolute level in 1991: 24 M -OPT absolute level in 1995: 29 M | -OPT absolute level in 1991: 2 M -OPT absolute level in 1995: 3.5 M | -OPT abs. level (1995): 38 M + 7 % 91/95 -OPT dep. (1995):13% (-29% 91/95) |

Edible Preparations

| | Germany | Netherlands | EU12 |
|-----------|--|--|--|
| Poland | - OPT absolute level in 1995: 22 M + 274 % 91/95 - opt dependence in 1995: 16 % + 164 % 91/95 - | -OPT absolute level in 1995: 3 M - 79 % 91/95 -OPT dependence in 1995: % - 82 % 91/95 | -OPT absolute level in 1995: 26 M + 17 % 91/95 -OPT dependence in 1995: 12% - 5 % 91/95 |
| Former CS | -OPT absolute level in 1995: 10 M + 3163 % 91/95 -OPT dependence in 1995: 38 % + 2724 % 91/95- | | -OPT absolute level in 1995: 10 M |
| CEEC4 | -OPT absolute level in 1991: 8 M -OPT absolute level in 1995: 33 M | -OPT absolute level in 1991: 16 M -OPT absolute level in 1995: 3 M | -OPT abs. level (1995): 36 M + 50 % 91/95 -OPT dependence (1995):10% + 59 % 91/95 |

Iron & Steel

| | Germany | France | EU12 |
|-----------|--|--|---|
| Poland | - OPT absolute level in 1995: 5 M 1 % 91/95 - opt dependence in 1995: 1 % | | -OPT absolute level in 1995: ~ 5 M |
| Former CS | -OPT absolute level in 1995: 21 M + 282 % 91/95 -OPT dependence in 1995: 2 % | -OPT absolute level in 1995: 2 M - 28 % -OPT dependence in 1995: 3 % - 54 % 91/95 | -OPT absolute level in 1995: 24 M |
| Hungary | -OPT absolute level in 1995: 1 M - 24 % 91/95 | | -OPT absolute level in 1995: 3 M |
| CEEC4 | -OPT absolute level in 1991: 11 M -OPT absolute level in 1995: 28 M | -OPT absolute level in 1991: 3.4 M -OPT absolute level in 1995: 2.3 M | -OPT abs. level (1995): 33 M + 111 % 91/95 -OPT dependence (1995):1% (+5%) |

Printing

| | Germany | EU12 |
|--------------|---|--|
| Former CS | -OPT absolute level in 1995: 13 M + 317 % 91/95 -OPT dependence in 1995: 28 % + 35 % 91/95 | -OPT absolute level in 1995: 13 M |
| CEEC4 | -OPT absolute level in 1991: 5 M -OPT absolute level in 1995: 13 M | -OPT abs. level (1995): 14 M + 197 % 91/95 -OPT dependence (1995): 16% + 78 % 91/95 |

Glassware

| EU12 |
|--|
| -OPT absolute level in 1995: 9 M |
| -OPT abs. level (1995): 9 M + 138 % 91/95 -OPT dep. (1995): 1% (+41% 91/95) |

Annex 3 Panel of OPT firms interviewed in the Czech Republic and Hungary

| Firms | Size | OPT proportion | Goods |
|------------------------------|---------------------------------|---------------------------------|--|
| OP Prostějov (Prague) | 6000 employees | 3/4 of exports; 50% production. | men trousers, jackets; women tailleurs, skirts |
| Timo (Prague) | 800 employees | 10-12% production | woman underwear, bras |
| ONA (Prostějov) | 175 employees | 1/12 production. | men suits, coats |
| Fekon (Budapest) | 1200 employees. | 90% production | blouses, men shirts |
| Elit (Budapest) | 1200 employees. | 70% production | mainly men suits |
| Styl (Szombathely) | 2100 employees. | 90% production | (wo)men jackets |
| CKD-Elektrotechnika (Prague) | 1000 employees, 100 in workshop | 100% | medical needles |
| ABB Elektro Praga (Prague) | 1130 employees. | high? | elec switches (wall) |
| Ateso (Prague) | 3180 employees. | very marginal | car assembly |
| PAL (Prague) | 4000 employees. | 3% tot output | assembly of motor |
| Choteborske Stro-jirny | 5000 employees | 5% | metal drum for medical machines |
| CKD-Tatra (Prague) | 1128 employees | 3-5% total production | parts for car underframe |
| Tesla Karlin (Prague) | 1050 employees. | 15% turn over | man distribution. frame |
| TOS Hostivar (Prague) | 550 employees. | 30% | grinding machines |
| Vilati (Budapest) | 480 employees. | 95% production | electr(on)ic comp. |
| VUOSO (Prague) | 29-20 employees. | 10-20% tot prod | measuring system |
| SVUS a.s. | 200 employees | 90% | medical drug |

Chapter 4. The Determinants of OPT between the EU and CEECs

The empirical evidence gathered in the previous Chapter paves the way for the systematisation and formalisation of the determinants of OPT 'trajectories'. In the face of the importance of the stake attached to the evolution of OPT relations between the EU and CEECs, two questions need to be answered in order to identify the contribution of OPT to the patterns of economic interdependence between the EU and CEECs:

-on which factors depend the respective probabilities that EU firms terminate their OPT engagement in CEECs, or on the contrary that they upgrade their commitment?

and,

-in which circumstances are local firms best prepared to face the strategic decision of their foreign partners (i.e., taking over OPT production on their own... or closing down)?

Two theoretical backgrounds have something to say on these issues: International Trade and International Production theories (hereafter IT and IP). Whether the former provide an answer as to *why* OPT develops in CEECs, the latter are in principle apt at answering *how* OPT is chosen by EU firms to extend their activities to CEECs. However, the 'division of labour' between these two bodies of theories is questionable, especially in the case of OPT where the trade and the production dimensions of this type of market linkage are indivisible. The combination of IT and IP theories is therefore necessary.

But even combined, the contribution of IT and IP is limited to account for the development of OPT between the EU and CEECs, and to give a clue as to its prospective evolution. As a matter of fact, there is a series of factors which the previous empirical Chapters show to be decisive in accounting for OPT trajectories and which IP and IT theories fail to acknowledge. Two of them figure pre-eminently among the determinants of OPT: the nature of the trade restriction enforced in the concerned sector, and the size of the partners party to an OPT agreement. An alternative ad-hoc explanatory scheme is proposed to make sense of them.

4.1 On the limited appropriateness of International Trade theories

To see what International Trade theories have to say about the above OPT story, the present section will proceed in the following way. First contending approaches will be assessed with respect to their appropriateness in the specific case of OPT trade between the EU and CEECs. Then, the lessons drawn from their predictions will be addressed.

Market mechanisms are what economic theories of international trade are about. Different approaches differ according to the type of mechanisms they identify. Handbooks traditionally distinguish between four main theoretical frameworks¹²⁷; three of them (the Ricardian theory, the Heckscher-Ohlin model, and the specific factor model) belong to the neo-classical paradigm, and are the objects of long-established traditions of research. A fourth current emerged more recently, and is compounded of heterogeneous contributions; the common point of this latter strand of researches is that they all depart from the assumption of perfect competition.¹²⁸ Finally, mention should be made of the neotechnology approaches to international trade; they consist of two different versions, the technology gap model (Posner, 1961), and the product cycle model (Vernon, 1966). These latter approaches are more like empirical generalisations of the world economy than properly predictive theories [Harris, 1992: 30].

Overall, in the present state of knowledge, two broad sets of determinants are considered to give rise to trade flows: comparative advantages and economies of scale. The question arises as to which of these market mechanisms underpin OPT trade between CEECs and Western Europe. Clearly, the question comprises two dimensions; the selection between contending models of international trade has to be done on the basis of their respective pertinence, first, concerning the particular case of CEECs' foreign trade, and second, taking into consideration the specific features of OPT.

1. The explanatory power of International Trade theories: generalities.

The basic opposition between comparative advantages and economies of scale as a source of trade flows rests on the fundamental antagonism concerning the issue as to whether it is differences or, on the contrary, similarities between economies that cause trade. The proponents of the first view consider international differences in factor costs to be a crucial determinant of trade; comparative advantages materialise because of either technological differences, or distinct factor endowments (hence the two versions of the "factor cost" theory, the Ricardian model and the Heckscher-Ohlin theorem). As to the second paradigm, it developed more recently, in response to empirical evidence showing the intensity of trade between

¹²⁷ See Leamer, in Greenaway, and Winters, (1994: 68).

¹²⁸ Two main sets of research programmes that deal with imperfect competition can be distinguished: the current concerned with strategic trade behaviours (so-called strategic trade theories), and that addressing the phenomena of intra-industry trade. A seminal work taking account of imperfect competition is Krugman (1979). Models that pioneered tackling product differentiation as an explanation for intra-industry trade are: Dixit, and Stiglitz (1977), Lancaster (1979). As to strategic trade theories, one of the first models was proposed by Brander and Spencer in 1984.

industrialised countries, despite their being characterised by similar factor endowments. Intra-industry trade, caused by economies of scale, and product differentiation, was identified as the explanation of such an anomaly in regard to traditional theories [Greenaway, 1987: 29].

A steady flow of research feeds the debate over the respective suitability of these various theoretical models for accounting for actual flows. Although it is characterised by serious shortcomings, the Heckscher-Ohlin model (HO) has been, and is still "regarded as one of the triumph of economic thought (...)" [Balance, 1988: 6]. From an epistemological viewpoint, it is indeed interesting to note the long-lasting supremacy of the neo-classical school of international trade. The model resisted several assaults, whether under the form of internal critique (the 'Leontief Paradox'¹²⁹), or resulting from external challenge (the acknowledged existence of intra-industry trade¹³⁰). It is not until the end of the 70s that the fame of the HO model started to be eroded; alternative paradigms could finally be taken seriously, and the so-called "new theories" of international trade take off.¹³¹ In the meantime, the neotechnological approaches to international trade, because they lack sound theoretical underpinnings, they are easily dismissed; but they had the merit of drawing attention to more 'data-oriented' considerations.

Models of international trade have all, to different extent, undergone several empirical testing. The HO model is probably one of the preferred candidate with resulting conclusions inevitably contradicting each others. One of the most definitive study on the matter is given in the in-depth study of E. Leamer, published in 1984.¹³² On the basis of a rigorous theoretical formulation of the theorem¹³³, he applied the proposition to the trade flows of around 60 countries between 1958 and 1975. Eleven sources of comparative advantage were tested (ranging from

¹²⁹Leontief found that the factor content of US exports in 1947 was more labour-intensive relative to capital than US imports (Leontief, 1954). Referring to *skilled* labour is the most common way to overcome the 'difficulty'. Leamer (1980) notes that Leontief misapplied the factor content version of the HO theorem in that he kept separate the computation of the factor content of exports and imports (in Greenaway, Winters, 1994: 74).

¹³⁰ It is, indeed, interesting to note that intra-industry trade is not necessarily a *recent* phenomena. On the basis of French trade data going back the 19th century, Messerlin and Becuwe conclude that intra-industry trade 'tends to be a rather permanent feature of trade flows between industrialised countries' (Messerlin, Becuwe, 1986: 196). However, intra-industry trade was "discovered" in 1975 in a seminal book by Grubel and Lloyd.

¹³¹ Adopting lakatosian conceptual tools, Macgovern (1994) offers an explanation that goes as follows: there had been early attempts to account for imperfect competition (by Joan Robinson, or Chamberlin as soon as 1933); however, they were doomed to fail as they were introduced in a so-called "progressive" phase of the neo-classical research programme (roughly corresponding to Samuelson's influence). Instead, the "degenerative" phase of the research programme favoured creative shifts, and greater attention paid to empirical evidence. Macgovern explains in this way how the model of Lovasy (1941) was only taken over by Krugman and Lancaster in 1979, and 1980 respectively.

¹³² Another ambitious survey was undertaken by the UNIDO in 1986. Here again, the findings confirm the overall philosophy of the notion of comparative advantage applied to international trade flows.

¹³³namely, the 'factor-content' version of the theorem, whose precursor was Vanek in 1968.

natural resources, unskilled labour, research and development, to physical capital). Overall, he finds that,

"the main current of international trade is well understood in terms of the abundance of a remarkably limited list of resources" [Leamer, 1984: 16].

Empirically testing models that deal with trade flows under imperfect competition is particularly delicate a task. There is, indeed, a specific difficulty in testing intra-industry trade models due to the often casual relation between theory and data [Leamer, 1994: 84]. It is, therefore, probably too early for an appraisal of their adequacy in describing actual trade flows. (...).¹²⁴

In the debate over the respective merit of the various theories of international trade, using empirical testing to claim the superiority of a model over the others once for all is, at best, vain. Leamer, for example, insists that rather than testing, and asking whether a theory is 'true', it is the accuracy and the usefulness of a model that should be assessed [Leamer, 1994: 66]. Thus, rather than purporting the universal validity of a model, one should focus on how best to combine the different explanatory frameworks, choosing them according to the empirical case under scrutiny [Greenaway, and Milner, 1987: 27]. Interestingly enough, Greenaway (1991: 157) evokes a 'paradigm specialisation' by country, whereby the HO model, as well as the Ricardian model are -implicitly or not- considered to be particularly appropriate for explaining the foreign trade of developing countries, whereas models assuming imperfect competition are reserved for the developed market economies.

2. International trade theories in the case of CEECs' foreign trade

In the name of this division of labour between theories, the HO theorem seems to be particularly pertinent in the case of Central and Eastern European foreign trade. In HO terms, trade occurs because of differences of factor endowments; it is therefore between economies which are most dissimilar that HO trade is most likely to occur¹²⁵. The argument can be applied to East-West relations, as the period of centralised allocation that CEECs underwent stamped their

¹²⁴ Leamer distinguishes 3 different types of tests: 1) the factor content studies to which the famous Leontief paradox belongs, 2) studies regressing the trade data of a country on the characteristics of the trade commodities (cross-section regression), and 3) tests implicitly inferring factors' intensity from the relation between trade and factor endowment in a cross-country analysis, the latter being adopted by Leamer.

¹²⁵In strict theoretical terms, however, countries should not be too dissimilar for trade to take place between them: their factor endowment should lie in the same 'cone of diversification'.

production structure, as well as their level of development, rendering them significantly different from their immediate western neighbours.

But this is not sufficient for ruling out economies-of-scale approaches. Indeed, several studies have emphasised the growing role of intra-industry trade also in South-South, and even North-South trade.¹³⁶ Whereas intra-industry trade between developed economies mainly occurs in differentiated products, intra-industry trade between developing countries and developed economies is attributable to the shipping of intermediate products participating in the internationalisation of production; this latter type of trade clearly corresponds to the OPT features.

Thus a 'paradigm specialisation' is at best insufficient for choosing the relevant theory in the case of CEECs trade. Other discriminating considerations need to be added.

Another criteria for appraising which theoretical framework best suits the case of CEECs' foreign trade, has to do with the fact that CEECs participate in a regional integration process. Indeed, it is often presumed that preferential, as opposed to multilateral, trade liberalisation is more likely to bring about intra-industry specialisation rather than inter-industry reallocation. The case for a causal relation between intra-industry trade and the liberalisation of trade in a regional context mainly rests on empirical findings, starting with the example of the European integration and its subsequent outburst of -unforeseen- intra-industry trade [Grubel, Lloyd, 1975: 133]. These findings were confirmed empirically in the case of other regional arrangements [Greenaway, 1989: 31]. On the basis of Latin American trade data, Balassa (1979b), for example, was able to generalise the proposition of a positive relation between intra-industry trade and regional liberalisation of trade in the case of developing countries; moreover, he fully acknowledged and investigated the possibility of intra-industry trade between developed and developing countries, which gives rise to horizontal, as well as vertical specialisation¹³⁷. However, following such empirical explorations, no real formal explanation was provided.

More recently, the validity of the relation tended to be qualified, if not questioned. Milner (1990), for example, gives only mild evidence of the impact of regional trade liberalisation on the development of intra-industry trade: it might very well be that trade liberalisation gives *simultaneously* rise to inter- and intra-industry specialisation. Greenaway (1989: 32) agrees that discriminatory trade liberalisation does not *per se* stimulates the growth of intra-industry trade. He rather puts the stress on the characteristics of 'pre-union market structures' (overlapping demands) as well as features usually associated with regional integration,

¹³⁶See for example, Balassa, (1979), and Greenaway, (1991: 166).

¹³⁷Intra-industry horizontal specialisation corresponds to the shipping of similar goods, but which are of distinct quality. Vertical specialisation involves the international exchange of goods in the view of processing them, and corresponds therefore to OPT.

such as the free movement of production factors and capital (fostering intra-firm trade whether horizontally or vertically¹²⁸, and recorded as intra-industry trade).

Overall, it seems sensible to acknowledge a correlation between regional integration and intra-industry trade. A direct causal relation might be usefully softened by time considerations; in the long run, intra-industry trade follows from the process of regional integration and is rather to be considered as a criteria for evaluating how deep integration really is.¹²⁹ In the case of Central and Eastern European countries, one might argue that, intra-industry trade theories *will* provide a pertinent framework for analysis as time passes by, and the structure of the respective economies converge. For the moment, traditional tools prove to be more adequate. Thus a widely acknowledged conclusion is that if a theoretical model is to be chosen among the IT paradigm for accounting for CEECs' foreign trade with the EU, then it is the HO model which is the most suitable one.

3. International trade theories in the case of OPT trade

The question is now to determine whether the HO model is also the most appropriate model to be used in the specific case of OPT trade. An important feature of OPT which rises some controversy in this respect is that it is quite akin to intra-industry trade. First, as a most direct evidence, OPT brings about a two-way trade which is most often classified within the same category of the Combined Nomenclature at 2-digit level. Moreover, OPT corresponds clearly to a sub-category of Intra-Industry Trade (hereafter IIT) as identified by those very scholars who pioneered the study of IIT. Grubel and Lloyd (1975: 114-8), for example, mention the case of the processing activities of multinational enterprises (goods are sent abroad to undergo processing before being imported back) as a source of IIT. Such processing activities are considered by other early scholars of IIT as a fully-fledged category classified in the typology of the different types of IIT. Gray (1973) describes it as belonging to category "C", i.e., IIT in components, whereas Helleiner (1973) provides number of examples of commodities involved in assembly activities abroad as an illustration of the rise of IIT. Finally, Willmore (1979) distinguishes between 3 distinct kinds of heterogeneous goods that give rise to IIT specialisation: goods produced with the same machines and skills, but belonging to different and narrow ranges of product lines, goods with different factor input requirements, and differentiated goods

¹²⁸Pomfret (1986) argues that vertical intra-firm trade is the principal explanation of recorded intra-industry trade. Quoted in Greenaway (1989: 34).

¹²⁹The extent of intra-industry trade can also be considered to be an indicator of the level of development of a country. Balassa and Bauwens, for example, established the existence of a positive correlation between the level of income of a country, and the proportion of intra-industry trade in its total foreign trade. (Balassa, Bauwens, 1988).

exchanged between monopolistic competitors; the second category corresponding to processing activities.

Interestingly enough, mention is often made of the specific custom regime contained in the US Tariff Schedule under which import duties are levied only on the value added abroad.¹⁴⁰ The above-mentioned studies use the trade data resulting from this specific custom treatment as evidence of intra-firm trade (this is almost taken for granted in Gray, 1973, Helleiner, 1973; Grubel and Lloyd, 1975; and Helleiner, 1981). Helleiner (1973)¹⁴¹ for example uses the above-mentioned American customs figures as evidence of the extending reach of US multinational firms' activities. Balassa, on the contrary, notes that vertical (as well as horizontal) specialisation is not necessarily of an intra-firm nature. He goes even further, and actually stresses the declining importance of US multinationals for organising the vertical integration of production processes on an international scale; in turn, the symmetric increasing role of contractual agreements shows the growing independence of US partners abroad¹⁴² [Balassa, 1979b: 261-65].

In general, it appears that scholars concerned with IIT paid particular attention to the American counterpart of OPT in the 60s and 70s. What is of interest here, is whether this kind of IIT is considered to require departure, or even refutation of traditional theories of international trade. The answer is more or less unanimous, and well summarised in Grubel and Lloyd (1975): the development of processing activities invites traditional theories to take account of 2 factors previously ignored, namely the role of transport costs, and that of information in determining trade patterns. For the rest, however,

"international assembly and finishing, which give rise to intra-industry trade because they involve the import and export of goods which often are reported in the same statistical category, are consistent with the Heckscher-Ohlin model since they represent the exploitation of comparative advantage in the production of certain services." [Grubel, Lloyd, 1975: 118].

Various studies have indeed endeavoured to establish the validity of the HO model in the case of trade in intermediate goods. Jones (1980), for example, tackles the case of production with a footloose factor which is exchanged on international markets. In doing so, he stresses the importance of *absolute*, alongside comparative advantages in determining production patterns. However, he is mainly concerned with the conditions to attract the footloose factor, whereas the

¹⁴⁰ Items 806.30 and 807.00 of the old US Tariff Schedule. See Part I.

¹⁴¹ Quoted in Balassa, (1979b).

¹⁴² Interestingly enough, Balassa considers that this process is hindered in Europe, due to the more restrictive character of the trade legislation pertaining to international processing activities.

output is simply considered to be geared to the national market.¹⁴³ Two other models (Sanyal, 1980; and Dixit and Grossman, 1982)¹⁴⁴ use the notion of comparative advantage to answer the question as to which "middle-products" a country does import and which it does export in a vertical production structure with many stages. Caves and Jones (1993: 165) further warrant that "the Heckscher-Ohlin theorem proves valuable for explaining which production processes have gravitated to the Newly Industrialising Countries". Overall, in strict theoretical terms, the introduction of intermediate goods does not alter the conclusions of the HO theorem.

4. On the prospect of OPT in CEECs from the viewpoint of International Trade theories

Among many potential candidate theories of International Trade, the notion of comparative advantage, and its formalisation in the Heckscher-Ohlin model seem to be the most pertinent paradigm in the case of OPT between the EU and CEECs. This is because of the differences in the level of development of the two areas under scrutiny, and because of the OPT contribution to the progressive liberalisation of exchanges between these two areas. Put simply, the HO theory affirms that a country enjoys a comparative advantage in (and therefore will export) the good whose production is relatively intensive in the factor with which that country is relatively well endowed [Jones, 1979: 5]. Thus, one might expect that the trade specialisation (and division of labour) resulting from OPT will take place along the lines of comparative advantages.

The argument put forward by an HO approach to OPT develops in a straightforward manner. As CEECs are characterised by a comparative advantage based on cheap labour as suggested by the empirical analysis of CEECs' comparative advantages of Chapter 2, CEECs' exports consist logically of labour-intensive goods. This is indeed in perfect harmony with OPT patterns of trade which fit particularly well in the Heckscher-Ohlin model. A rough analysis of Czech OPT trade shows that indeed the relation between the three variables considered by the HO theorem (factor abundance, factor intensity, and trade) complies with the predictions of the model. Indeed, being in their vast majority labour-intensive, the products concerned by OPT operations are of an "heckscher-ohlinian" nature, i.e., based on cheap labour which is the comparative advantage currently characterising CEECs economies. It is therefore natural that these OPT goods lie in the specialisation area of the CEECs economies, which, on the basis of

¹⁴³ In Sanyal and Jones (1982), an extended version of the model is proposed that splits goods into two different sets: the input and the output tiers; but here again, outputs are not supposed to be re-exported.

¹⁴⁴ Quoted in Jones and Neary (1982: 36).

the wage differential with their trade partners, can be considered to be relatively well endowed with labour.

The case of OPT trade in the Textile and Clothing industry is particularly interesting in that it can be easily kept track of the path followed by the goods involved in OPT transactions. The pattern is clear: from any of the EU member states, imports for OPT are generally much higher in the textile sector than in the clothing sector. On the contrary, exports after OPT are massively concentrated in the clothing sector, with a stronger polarisation between textile and clothing. German firms, for example, export temporarily man-made staple fibres (heading 55 of the Combined Nomenclature), cotton (52), wool (51), man-made filaments (54) ... and import back almost exclusively articles of apparels not knitted or crocheted (heading 62 of the CN). The Heckscher-Ohlin theory is particularly adequate to account for such a pattern as the textile industry is commonly more capital-intensive than the clothing industry.¹⁴⁵ It makes sense, therefore, that EU members who are more competitive in the capital and technology-intensive textile goods export the latter and re-import back labour-intensive apparels.

Hence the fundamental conclusion achieved by the application of the HO theory to the OPT case: if OPT trade takes place along the lines of a comparative advantage based on labour, then as wages increase ... OPT trade is to decrease.

5. Limitations

Such a conclusion is far too simplistic to account for quite a complex reality. In fact, it needs to be qualified, modified, adapted ... and eventually, perhaps, even rejected.

Theoretical Critical Assessment

The HO approach is first characterised by serious shortcomings which are of a very theoretical nature. Hence a critique of the model from 'within', convincingly put forward by alternative IT approaches. Two of them are of particular relevance in the case of the issues at stake in OPT trade.

¹⁴⁵ In the industrialised countries' clothing industries, labour costs account for 35-40% of total costs compared to 12-16% in the textile industries. See Graziani, (1994: 12).

a) the static bias of the Heckscher-Ohlin model

One serious shortcoming of the HO model for the present purpose, is that comparative advantage is a static notion: the HO model claims to explain trade patterns at a point in time, not to predict future trends. In this respect, it is interesting, in passing to note the irony of the above-mentioned paradigm specialisation thereby the very static HO is reserved to *developing* countries. Overall there is only little possibility to remedy the situation if one is to stick to an approach in strict IT terms.

There are of course alternative models which attempt to tackle time issues, but they have only little relevance in the case of OPT. For example, the popular Product Cycle model's primary objective is to account for innovation, by predicting trade patterns without resorting to the notion of comparative advantage [Vernon, 1966]¹⁴⁶. New products are first launched on domestic markets (usually characterised by strong demand, and high wage levels), irrespective of questions of cost; they then mature and start to be exported as demand arises also abroad; finally, their production process become standardised, and can be relocated where labour costs are more favourable. Apart from the paucity of empirical evidence validating such a model¹⁴⁷, the problem as far as OPT is concerned, is that the latter does not account for trade in intermediary products. Its inadequacy in dealing with OPT is therefore straightforward.

Thus, the only (compromise) solution consists in adopting the HO model as a starting point, and complementing it with dynamic considerations. Future trends are indeed commonly merely inferred from current comparative advantages, even if this is clearly an usurpation of the theory.¹⁴⁸ Theoretically sounder, Balassa (1979) proposed the "stage-approach" to comparative advantage. He relates changes in comparative advantage to changes in factor endowments, and considers that the structure of exports changes in line with the accumulation of physical and human capital. Eventually, comparative advantages move along a scale going from the most labour-intensive products to the most capital-intensive goods. In simple terms, the question is therefore to determine whether the referred economies are characterised by hidden or latent assets, like a skilled workforce for example. The Asian Newly Industrialised Countries (and Japan at an earlier stage) are often considered to be cases in point in this respect, as comparative advantages shifted away from unskilled labour intensive products to more capital and technology

¹⁴⁶ The two approaches, HO and PCM, can nevertheless be combined.

¹⁴⁷ See on the matter Vernon, (1979).

¹⁴⁸ Tuong and Yeats (1980: 526), for example, use a historical analysis to justify the extrapolation of the future trade patterns of Developing countries from their actual endowment in labour. They computed the labour intensities of the best performing exports of a sample of Developing countries, and found that "labour intensity provide (...) a very useful guide to products in which the LDCs make their best performance". On the basis of another series of computation determining that labour-intensive products have become even more so over the interval 1965-1976, they conclude that labour intensity is indeed a good indicator of future trends.

intensive goods.¹⁴⁹ As far as OPT is concerned, the lessons to be drawn from such theoretical developments are clear: will the factor endowment of the CEECs economies upgrade, yielding a lower labour content of trade; and if yes, with what impact on OPT trade?

b) the complexity of patterns of comparative advantages in presence of intermediate goods

Even more challenging is the treatment made by HO of trade in intermediate goods. Indeed, the formalisation of semi-finished goods into the model present above is itself rather delicate. What is more, none of the mentioned attempts strictly correspond to the OPT features. Their shortcoming is that they adopt a view in which products undergo a *continuum* of processing stages. The circularity proper to OPT trade is therefore not taken into consideration. However intuitive or formally justified, the extension of the HO model to intermediate goods will be taken for granted. On the face of it, it seems more sensible to state that countries "specialise in a particular stage of internationalised production process which corresponds, in terms of factor intensity, to their relative factor endowment" [Nagarajan, 1995].

Taking account of the importance of intermediate goods in international trade flows entails consequences that, actually, go beyond the question of their difficult formalisation within the HO model. In the words of Ballance,

"patterns of trade and product specialisation entail much more than the processing of indigenous raw materials into final goods which are either consumed at home or exported. Instead, they are highly interdependent processes whereby some countries produce and export raw materials to others, which process the materials into intermediate products for export to third countries for yet further processing. The degree of interdependence, the number of processing stages, and the international location of these stages will vary *among industries*" [Ballance, 1988: 16]¹⁵⁰.

International vertical chains of production processes can indeed, overlap, in association with intricate patterns of comparative advantages. As a result, the simple predictions of the HO model, for which two trading partners are defined by well-determined comparative advantages, are obscured. Even more importantly, Ballance's apparently innocent remark suggests that countries do not specialise so much in products, but rather in stages of production. Lassudrie-Duchene (1982), for example, corroborates this view; his starting point is the notion of

¹⁴⁹ There is however contradicting empirical evidence. In Ballance, Ansari, and Singer (1982), for example, countries were classified into 4 groups according to their level of development. Indicators of their comparative advantage were then compared, but no sequential pattern could be detected. Quoted in Ballance (1988: 19).

¹⁵⁰ Emphasis added.

"International Division of the Production Process", whereas the notion of comparative advantage comes only second, as an explanatory factor for the location of the different stages.

If one goes to the bottom of this stream of reasoning, it appears that the markets of two trading partners are maybe not the only relevant units of analysis for capturing international trade flows in intermediate goods. In fact, the organisation of the production process differs according to the industry considered. Moreover, it is important to bear in mind that the division of the production process is organised within the network of firms participating to the internationalisation of production. This implies that comparative advantages are not the only determinants of trade patterns; firms' internalisation strategies, as well as industry characteristics, are also important factors. In other terms, the point is reached where theories of International Production, dealing with organisational factors as well as market forces, have to take over a trade-centred analysis.¹⁵¹

Inadequacy in the case of OPT

If it is defensible to believe that OPT trade takes place along the lines of CEECs' comparative advantages. Such a view nevertheless bypasses two fundamental features of OPT, its 'quasi intra-firm' nature, and the fact that it owes its existence to the presence of trade barriers.

It would be indeed quite naive to believe that it is comparative advantages 'per se' which are the determinants of OPT. In fact, out of a peculiar irony, OPT trade takes place along the lines of comparative advantages ... because this is where trade protection is. In other terms, OPT trade develops where policy makers *think* CEECs' comparative advantages lie. That OPT trade develops effectively along the lines of comparative advantages as defined by neo-liberal IT theories simply shows that policy-makers have a good command of their IT textbook.

More generally, the OPT example shows that the mode and the speed of trade liberalisation have a direct influence on the patterns of trade specialisation. Rather than 'taking place along the lines of CEECs comparative advantages' as intended in a conventional IT perspective, OPT trade is determined by the structure of trade protection still in place between the EU and CEECs. Of course, the fundamental rationale of OPT trade is to take advantage of low labour costs, but OPT *primarily* develops where there are trade barriers dissuading local producers to penetrate Community markets on their own, while motivating EU firms to take advantage of the beneficial treatment reserved to them.

¹⁵¹ In the International Production terminology, the *internalisation* advantage is to be combined with the *locational* advantage. The OLI paradigm developed by Dunning (1979) is addressed in the following section.

This is in sharp contrast with the view defended by Milner, according to whom 'man-made' factors i.e., the form of trade liberalisation, does not significantly bear upon trade patterns in the long run [Milner, 1988]. We are in fact closer to the view defended by Borrus and Tyson according to which comparative advantages are 'created', even though it does not pinpoint the process of trade liberalisation as an instrument to create such comparative advantages [Krugman, 1986].

In short, the correspondence between OPT trade, CEECs' comparative advantages, and trade barriers is no coincidence.

This brings us to a second drawback of an IT approach arising from its neglect of corporate variables. It is one thing to determine potential poles around which CEECs foreign trade in general and OPT trade in particular is likely to develop; but the question of the actual beneficiaries of such potentials requires a separate answer, if not an alternative approach. Indeed, adopting markets as a relevant unit of analysis is not apt at answering the how and the 'cui bono' questions of OPT. Even if it is at arm's length, the fact that OPT transactions take place within a networks of firms linked by an agreement is crucial in this respect. As a matter of fact, it is clear that CEECs' comparative advantages are exploited through OPT by foreign partners and at the expense of local firms' independent exports.

The present study thus complements the view of those who maintain that the Community deliberately erected trade barriers where CEECs have a comparative advantage. Indeed, EU policy-makers also *use* trade liberalisation through a discriminatory handling of the removal of trade barriers of which OPT is nothing but an example. The process of trade liberalisation depicted in Chapter 2, is thus an important factor determining where and how (by whom) potential CEECs assets can be exploited. In this respect, the OPT legislative features appear to be a powerful factor favouring Western firms at the expense of local producers' independent exports.

Overall, the fact that OPT trade takes place within a network of firms is very likely to blur the seemingly irreducible conclusion according to which wage increases will be fatal to OPT trade. In a formal way, actually, the statistical evidence presented in Chapter 3 gives credit to such a conclusion: OPT trade, as a rule of thumbs is indeed decreasing. But it was argued that decreasing OPT trends conceal a fundamental indeterminacy: do they correspond to the withdrawal of foreign partners, or on the contrary to the upgrading of OPT agreements into more durable and equal partnerships? It is important to distinguish between the two cases as indeed, the consequences in terms of local development and for the regional division of labour are completely different. In other terms, acknowledging the fact that OPT is the product of firms decision rather than mere transactions taking place between markets characterised by different

factor endowments is likely to make more complex the actual determinants of OPT and its likely consequences.

In conclusion, the fundamental shortcoming of the notion of comparative advantages (and of IT approaches in general) for accounting for OPT is that it fails to acknowledge the connection between firms' international production activities and international trade flows. This is quite a serious drawback in a world economy where a growing proportion of international trade is due to firms' international production activities.¹²² We would thus give credit to the first part of Leamer's prediction according to whom

"the biggest story of the next decade will be the economic integration of the high-wage industrialized countries with the low-wage developing countries, and Heckscher-Ohlin is the model of choice" [CEPR, 1994: 34]¹²³

... and dismiss the rest.

4.2 On the partial relevance of International Production theories

The conclusion achieved by an approach in IT terms is that it is necessary to bring into the picture the *network* of firms within which OPT takes place: OPT is indeed a matter of firms' decision. Although highly diversified, International Production theories ask the question as to *how* (and to a lesser extent *where* and *when*¹²⁴) national firms decide to go abroad. It is thus natural to turn to them to see what they have to say on the specific OPT strategy. It might be, however, that rather than providing with a complete, and ready-made explanatory pattern for OPT, the exercise will display some of the weaknesses of IP theories.

¹²² Hence the fundamental bias of most of the studies addressing the development of CEECs foreign trade, which fail to distinguish between 'normal' flows and temporary OPT exchanges.

¹²³ See also Alasdair Smith in Greenaway and Winters (1994: 43).

¹²⁴ This is valid for the so-called neo-technological theories of the 60s, of which Vernon's product cycle theory is an outstanding example.

1. Earlier theoretical developments and the study of internalisation

International Production theories form a disparate set of various theoretical contributions. Perhaps as a reflection of the complexity of the object they describe, they are highly diversified and sometimes hardly complementary. Different strands correspond to the different theoretical backgrounds they come from. For example, internalisation theories draw on the traditional theory of the firm based on the Coasian distinction between firm and market. Alternatively, the school initiated by S. Hymer and his seminal dissertation owes much of its substance to Industrial Organisation concepts.

Dunning's merit consists in bringing together the various contributions in an appropriately named 'eclectic' framework for analysis¹⁵³. Briefly summarised, the argument goes as follows: a firm invests abroad when it has an 'ownership' advantage at its disposal that it can internalise [Dunning, 1979]. Ownership advantages can be of various sorts: deriving from the privileged possession of an income-generating asset; enjoyed by a branch firm as compared to a greenfield plant; resulting from geographical diversification¹⁵⁴. As to internalisation advantages, they arise either from risk, from the ability of firms to exploit economies of scale, or, alternatively, from the existence of a benefit associated with the transaction which cannot be taken into account in an externalised form [Dunning, 1988].¹⁵⁷ The ownership and internalisation advantages ('O' and 'I') answer the 'how' question of international production theories, i.e., which is the best route for servicing foreign markets. Finally, locational advantages ('L'), explain *where* international production activities will take place, i.e., where firm-, and country-specific advantages match. This latter series is in common with (if not directly taken over from) international trade theories; the only difference is that, when combined with the two other determinants of international production, they allow for introducing government intervention, as well as the existence of intermediate goods (...).

Applying the eclectic theory in the case of non-equity forms of international production requires first, to understand the rationale underlying the internalisation decision then, the reasons why firms did not actually resort to internalisation. There are two distinct sets of factors bringing about internalisation. Buckley and Casson, who were the first to make an explicit association between the notion of internalisation and that of market imperfections in an international context,

¹⁵³ One of the first formulation of the 'eclectic' paradigm is in Dunning, (1979).

¹⁵⁴ In Dunning, (1976), quoted in Dunning (1988).

¹⁵⁷ More detailed reasons to internalise are given in Dunning's 1979 paper. There are 6 of them: to reduce transaction costs, avoid paying the selling firm price; to gain advantage over a competitor; to exploit or protect against government intervention; to protect specific property rights; to make a better use of capacities or overheads. It is worth noting that according to Dunning, the propensity to internalise varies with the concerned industries, and the country of origin.

adopt a Coasian approach: there are imperfections on markets of intermediate products resulting from transaction costs which explain why firms resort to *vertical* international integration [Buckley, Casson, 1976]¹³⁸. Instead, Hymer's interpretation of internalisation has more to do with market power than with intrinsic market inefficiency: by internalising, certain (big) firms are in a position to raise barriers to entry on the markets, thus generating a rent.¹³⁹ This second approach is more appropriate to address the *horizontal* dimension of international integration.¹⁴⁰ Beyond this distinction, determinants of internalisation have broadly to do with market failures.¹⁴¹ The choice of the most appropriate vehicle for international production (foreign direct investment or licensing) is mainly made on the basis of firm-specific assets: internalisation is not necessary when these latter are "easily identified and vested in exclusive and freely transferable property rights" [Buckley, Casson, 1985: 52].¹⁴² Other related factors are relevant, such as the degree of standardisation of the concerned products, and the extent of the segmentation of the markets for goods and factors [Rugman].¹⁴³ A last important factor favouring non-equity forms of international production, consists of obstacles to internalisation erected by government policy [Oman, 1984].

Overall, in the eclectic paradigm, the account of non-equity forms of international production, is relatively neglected. The reason is ultimately ascribable to the conditions under which IP theories were born. As a matter of fact, the *raison d'être* of IP theories is the refutation of the basic assumption of IT theories, i.e., the immobility of production factors: as opposed (in addition) to a world where only goods are mobile, the IP paradigm is interested in the possibility of capital transfers. Removing the unrealistic assumption of capital immobility is indeed a necessary step toward a more faithful account of the world economy¹⁴⁴; the problem is that almost by reaction, international production activities tackled by IP theories thus tend to become

¹³⁸ Interestingly enough, they also mention the cost associated with internalisation.

¹³⁹ See Dunning and Rugman (1985), as well as Tece (1985).

¹⁴⁰ See also Caves, (1971).

¹⁴¹ In a refined version of the eclectic theory, Dunning brings the 2 categories of ownership advantages together and identifies asset advantages (Oa) and transaction advantages (Ot); whereas asset advantages are likely to form a structural and country-specific category, the latter is more firm-specific. See Dunning (1983), quoted in Dunning (1988).

¹⁴² This approach is in contrast to the earlier theories of 'internationalisation' which rather adopt a stage approach to the various modalities of foreign involvement: because going abroad is considered to be risky in itself, a firm will start to explore foreign markets through the less demanding form of involvement, namely licensing. It will subsequently increase the degree of its commitment, and eventually end up investing capital. See the description of Perlmutter's views in Rugman, (1980).

¹⁴³ In addition, financial tools can be adopted. See, for example, Hirsch (1976) who weight the different possibilities on the basis of their respective 'net present value'. As to Contractor (1984), he considers the 'appropriability' of the margins extractable from the various forms of international production, and ponders their respective risk-adjusted 'net present values'.

¹⁴⁴ Mundell (1957)

synonymous with integration.¹⁴⁵ Hence the opposition between international trade theories dealing with market transactions, and international production theories in charge of transactions taking place within firms.

The result is that intermediate forms of international production hardly fit in such a rigid division of labour between IT and IP. As illustrated by the above analysis, the only way to address non-equity co-operation is in second-best terms: being internalised transactions optimal forms of international production, incomplete integration might nevertheless be justified when the former are not necessary or difficult to achieve.¹⁴⁶ But as a rule of thumbs, it is considered that a higher degree of *control* results from integration, which in turn brings about higher returns [Anderson and Gatignon, 1986]¹⁴⁷. What is more, the mere opposition licensing / investing¹⁴⁸ is obviously insufficient to account for the variety of international production forms [Stopford, Strange, 1991: 67]. This shortcoming is itself related to the failure of the theory to acknowledge distinct objectives of international production.¹⁴⁹

2. Approaches to non-equity forms of international production activities

In response to converging empirical evidence, renewed attempts to address the question of co-operative ventures considered the latter to form a fully-fledged category between market and hierarchy. Two empirical developments in the world economy eroded the centrality of the notion of internalisation¹⁵⁰, putting increasing strain on traditional 2nd best approaches.

¹⁴⁵ Tellingly, Dunning defines international production as the production which is "financed by foreign direct investment and undertaken by multinational enterprises" (Dunning, 1988: 1).

¹⁴⁶ In the IP literature, licensing is considered to be almost always more expensive than internalisation: because of the danger of knowledge dissipation, and because of the difficulty of the two partners to agree on a price. This is so also because of the important 'policing' costs associated with the enforcement of contracts (see Buckley, Casson, 1985: 53). As to Contractor, he identifies 4 categories of costs higher when licensing: sunk research costs, general administration cost, marketisation costs, and opportunity costs (1984).

¹⁴⁷ Interestingly enough, Anderson and Gatignon evoke briefly the possibility that control can be secured by other means than integration (Anderson, Gatignon, 1986).

¹⁴⁸ Three ways of "servicing foreign markets" are taken into consideration in the early IP literature: FDI, licensing, and exports.

¹⁴⁹ One attempt to connect the analysis of *how* firms go abroad to the question of *why* they do so is provided by Dunning's typology of the different objectives pursued by firms embarking on international production which has been widely taken over in the rest of the literature: firms that go abroad may be resources seeking, market seeking, or efficiency seeking (see Dunning, 1979 and 1988). The problem is that Dunning does not go into the details as to how the weight of the 3 OLI determinants varies according to the different motives for international production. These latter are clearly not the main concern of the theory. See Section 3.

¹⁵⁰ See Michalet's arguments on the development of a contractual phase in the process of globalisation (Michalet, 1991).

First, the recognition in the 1970s of so-called "New Forms of Investment" (NFIs)¹⁷¹. These consist of Joint Ventures, licensing agreements, management contracts, franchising, turnkey agreement, 'product-in-hand' contracts, production-sharing and risk-service contracts, and last but not least, international sub-contracting [Oman, 1988: 834]¹⁷². There is something 'new' about this first wave, but what exactly, is not completely clear. Oman evokes the sudden growing importance of co-operative ventures in the relatively untraditional setting formed by the developing countries [Oman, 1988: 384]. In this view, what Germidis call 'non-investment'¹⁷³ responds to the complementary objectives of the host states and the investing firms: to secure technology and access to markets while preserving sovereignty on the one hand, and to minimise risks taken in an uncertain environment on the other hand.¹⁷⁴

A second wave of contractual agreements was identified in the 80s as the development of "co-operative ventures" [Contractor, Lorange, 1988] or "cross-border non-equity collaborative venture". As opposed to the NFI of the 70s, this second wave is more clearly innovative. To the list of forms previously identified, are added alliances between multinationals that pool resource in areas such as R&D ...¹⁷⁵. The setting for this development, this time, is the developed economies of the Northern hemisphere. Such new types of co-operation agreements tend to occur between firms of similar production profile and size, which are, so to speak, on a more equal footing; they often take place in order to rationalise the activities of firms that go global [Contractor, Lorange, 1988: ?]. Of course, the development of strategic alliances and to a lesser extent, of contractual agreements remains marginal if compared, for example, to the unprecedented series of mergers and acquisitions that took place at the same time. The rationale put forward for explaining why firms resort increasingly to externalised forms of international production has shifted away from a 2nd-best logic to arguments departing more openly from 'mainstream' International Production theories.

Such 'waves' of co-operative ventures and their analysis are not properly speaking a great novelty. At the end of the 50s, Houssiaux already addressed Sub-Contracting in a very similar way [Houssiaux, 1957].¹⁷⁶ Later followed by Blois¹⁷⁷, he considered that Sub-Contracting is akin to the 'vertical quasi-integration' of the firms party to such an agreement: while bypassing integration, it substitutes for markets achieving an intermediary position [op. cit.: 221]. In this view, Sub-Contracting is

¹⁷¹ See Oman, 1984, and 1988; Chapter I in Rugman, 1982; and Chapter III in Buckley, Casson (1985).

¹⁷² Build Operate Transfer (BOT) should be added to the list.

¹⁷³ See Germidis (1980:37)

¹⁷⁴ For an empirical illustration of this point in the case of German investing firms, see Pollak in Oman, (1984: 264-268).

¹⁷⁵ Michalet, and Delapierre (1989: 2) distinguish between alliances and association agreements. The latter roughly correspond to the above-described NFIs, and bring about the organisation of MNF under the form of a network of contractual relations.

¹⁷⁶ The analysis was restricted to the national setting, though.

¹⁷⁷ See Blois, (1972).

"a device for economic integration, not within a firm, but within the group made of a big firm and its sub-contractors" [Houssiaux, 1957: 222].

An interesting feature of approaches aiming at a first-best account of co-operative venture is their emphasis on the mutations at stake in the world economy. One important mutation has to do with changes in the modalities of international competition which is becoming 'global' [Stopford, Strange, 1991: 65]¹⁷⁸. Implications are unnumbered and not yet appropriately grasped in an all-encompassing framework for analysis¹⁷⁹; however, it is generally agreed that what is at stake is the old fordist model. These mutations translate at different levels: into new organisation of the production process¹⁸⁰, new assets at the basis of firms' competitive advantages¹⁸¹, and whether cause or consequence, new conditions of demand¹⁸² ... last but not least, the new conditions of competition bring about inevitable consequences on the modalities thereby firms relate to each other: in the words of Contractor and Lorange, a firm is now to be viewed as

"... a coalition of interlocked quasi-arm's-length relationships" [Contractor, Lorange, 1988: 5]

Overall, these trends invite to reconsider the traditional primacy of the notion of internalisation [Delapierre, Michalet, 1989]: new patterns in the conditions of international competition call for more flexibility and adaptability rendering co-operative agreements particularly attractive. These changes require

"a general view of international competition to account for the various forms of international economic relations as different modalities for organising production on a world-wide scale" [Ravix, Charbit, Romani, 1989: 38].

However, nothing can be said beyond general considerations about the appropriateness of non-equity agreements for acquiring flexibility; in particular, concerning the determinants of

¹⁷⁸ Stopford and Strange propose to define global competition as 'the outcome of how individual firms have reacted over time to the changing balance of opportunity and threat' at work in the world economy (1991: 65).

¹⁷⁹ An interesting attempt is given in Ruijrok and van Tulder (1995).

¹⁸⁰ With the development of just-in-time and ... methods of production which correspond to new priorities such as flexibility. See Altersohn (1992: 102).

¹⁸¹ Technology, and beyond knowledge, is becoming an increasingly important factor determining the terms of the competition between firms. See Stopford, and Strange (1991: 34, and 71).

¹⁸² More changing and even unstable, see Oman (1988: 387).

such forms of international production. A good question in this respect is how far non-equity forms of international production can be treated together.¹³ In other terms, the doubt as to whether co-operative ventures really form an homogeneous category questions the validity of the double reference to market and integration [Michalet, Delapierre, 1989: 27].¹⁴ For example, Contractor and Lorange, who pioneered the study of co-operative ventures as a fully-fledged category, provide a good example of how difficult it is to use the intermediary position between market and hierarchy as a sufficiently discriminative criteria: they start by defining a spectrum of possibilities that goes from 'spot transactions' to 'complete merger' (1988: 5), then evoke the 'two extremes of full integration and purely contractual relationships' (1988: 16).

The main shortcoming of a view resting on the prominence of the commonalities of non-equity agreements (their rejection of complete internalisation) over their differences, is that it neglects the *rationale* of such forms of international production. In a sense, focusing on the specific traits of co-operative ventures in order to rectify the drawback characterising earlier IP theories (their excessive focus on internalisation) brings about a very similar bias. In both cases, the underlying problem is that weighting the comparative merits of different forms of international production does not take into account the different objectives of international production. This approach would do if the question at stake is "which is the best route for servicing foreign markets" but not if it is "how best to combine different vehicles of international production for simultaneously achieving a wide range of different objectives". On the face of the multiplication of variables, what is at stake is therefore the possibility of a comprehensive and exhaustive theory of International Production.

3. The study of the relocation of international production activities

Several approaches are mainly concerned by the objective pursued by a firm when it undertakes international production activities. This perspective enables to tackle new trends at work in the world economy which are exemplified by OPT. From a situation where the search for

¹³ "Alliances" and co-operation agreements are most often studied together, but however implicitly neglected, their distinctive features often appear clearly in such studies: whereas alliances are concluded between firms that keep their separate identity, agreements have to do with the reorganisation of MNEs into "multinational network firms" (Delapierre, Michalet, 1989: 28). Michalet (1988: 272) distinguishes between co-operative ventures by ordering them on a spectrum of possibilities that goes from market transactions to complete organisation.

¹⁴ See also Rullière and Torre who argue in favour of a distinction between horizontal and vertical types of co-operative ventures. There are converging opinions which consider the hybrid position between market and hierarchy to be a valid criteria in the case of vertical arrangement alone, whereas horizontal co-operative ventures would be governed by a logic on their own: see the above paper by Rullière and Torre, as well as Delapierre (1991: 146).

markets was the dominant rationale for going abroad, current developments rather correspond to the necessity of finding advantageous production sites. In Michalet's terminology, the tendency to shift from *filliale-relais* to *filliale-atelier* drives the current globalisation of production activities [Michalet, 1976].

Some studies choose to address the specific question of the *relocation* of economic activity abroad. They put forward a definition which indeed corresponds to the OPT case: in its largest interpretation, there is international relocation when a production unit closes in country A, and reopens in country B.¹⁰⁵ As a direct consequence, trade flows take place between A and B.

The problem with the debate over relocation is that it is dominated by the question of how restricted the definition of relocation should be. Does it have to encompass *total* relocation (with the transfer of all the economic activity, and the complete shutting down of the concerned plants in the country of origin) or merely *partial* relocation (with the relocation of only some segments of the whole production process; i.e., in Lassudrie-Duchêne's terms, the International Division of the Production Process [Lassudrie-Duchêne, 1982])? Similarly, does relocation refer to a symmetric process (thereby the loss of economic activity in A equally amounts the gain in B), or can the notion be extended to cases when there is an overall increase of economic activity? Finally, relocation might, but need not, entail capital flows: is it necessary to give consideration only to situations involving international transfers of capital, leaving aside the case of international sub-contracting? Such controversies hardly conceal the objective of achieving a definition of relocation making the assessment of its effect on home countries' main economic indicators (in particular, unemployment) as comfortable as possible. In short, what is at stake in these taxonomic issues is how best to study the impact of relocation on domestic employment.¹⁰⁶

Because of this bias, the study of relocation presents only poor analytical validity for addressing OPT. Their explicit objective notwithstanding, such studies are nevertheless interesting in that they adopt a perspective unveiling the inseparable nature of the relocation of international production activities and of its related trade flows: if firms go abroad aiming at better production locations, international production activities necessarily entail one trade flows ('re-imports') if not two (preliminary exports).

Efforts made to address sub-contracting activities in an international setting is also of interest for understanding OPT. According to a minimal definition of International Sub-Contracting (ISC), a foreign firm gives the injunction to a local firms to perform certain tasks according to a blue print provided by the former [Germidis, 1980]: what (implicitly) differentiates ISC from licensing is that the output is not geared to local markets, but is instead

¹⁰⁵ See Sachwald (1995), or Lahille (1995: 3). Mouhoud (1993) even defines "re-relocation", when relocations are transferred back in the country of origin.

¹⁰⁶ See for example the research undertaken by Alasdair Smith.

re-imported; OPT would be a specific case of ISC in that the foreign partner also provides the inputs. Although theoretical developments on ISC are scarce, and what is more, again overwhelmingly limited to considerations dealing with taxonomic issues¹⁶⁷, they all resort, to some extent, to the double reference of international production and its related international trade flows. Watanabe, for example, is one of the first to propose a rigorous typology of ISC [Watanabe, 1972]. He crosses two criteria: the first one allows to distinguish between the case when the foreign partner's activity is limited to market the products which undergo processing (commercial sub-contracting), and the case when foreign partners also participate in the production process (industrial sub-contracting); a second criteria discriminates between transactions taking place among agents of different nationality within the same country (inward sub-contracting), or transactions giving rise to international trade flows (outward sub-contracting). Four categories are thus defined. The main problem in Watanabe's view, is that the 2 logics of international production and international trade risk to be held distinct (commercial "or" industrial sub-contracting); on the face of it, its main advantage is that it holds a view in which firms are the instigators of ISC, whether in the context of the internationalisation of their production process, or whether ISC simply gives rise to international trade flows.

Michalet proposes a different typology which places the emphasis on the nature of the relations between the contracting partners [Michalet, 1980]. In type "A", ISC takes place between two independent firms located in two countries at different levels of development. Type "B" refers to transactions taking place between a MNCs' affiliate and a local firms, whereas type "C" concerns the relations between two affiliates of MNCs in a same country. Finally, type "D" of ISC is ascribable to the relations between the mother company of a MNC and its affiliate(s). To justify this latter category, Michalet argues that sub-contracting brings about a sort of economic dependence, whether the concerned firms are autonomous from a legal viewpoint or not. There is thus no point in limiting ISC to legally independent firms. In this view, as opposed to the *national* case where sub-contracting relations occurs between legally distinct firms, for *international* sub-contracting to take place, it is enough that the concerned firms be located in different countries or at least, be of different nationality [Hanaut, 1988: 326]. An additional argument is that if relations between parent companies and affiliates are not considered when addressing international sub-contracting, then the extent of the latter is significantly reduced ... This last argument is not of great analytical help. As to the former, it is highly controversial, but it has the immense merit of insisting that, while entailing international trade flows, ISC brings

¹⁶⁷ Number of them are drawn from typologies established in a national context. See, for example, the distinction between sub-contracting of speciality, and of capacity. A third category is sometimes identified as 'economic sub-contracting' which peculiarity is to take advantage of low costs [Michalet, 1980]. These types of criteria quickly appear to be limited as they often (or even systematically) overlap with one another.

about "economic dependence" proper to international production activity, whether through contractual or ownership links.

However deprived from explanatory power, these typologies (in particular Michalet's) make two essential points. First, relocation is simultaneously ascribable to the two logics of international production and of international trade. Second, IP-related trade flows can be of an intra-firm nature or they can take place at arms' length; the issue is after all of secondary importance since what really matters is that in both cases they occur within firms' network, and as a result of firms' initiative.

Their respective weaknesses notwithstanding, both series of studies on relocation and on International Sub-Contracting are interesting because of the underlying assumption they make on the objective that firms pursue when they go abroad. What is at stake is indeed the exploitation of local assets, i.e., without euphemism, of cheap labour...

4. Appropriateness and limitation

Intrinsic weaknesses

Thanks to IP theories, firms are no longer 'black boxes'; they are finally considered to be fully-fledged actors in the determination of international economic exchanges. The problem is that however deserving the attempt to address a higher degree of complexity, IP theories might not be entirely successful in tackling the difficulty. It is as though, in contrast to IT approaches, by allowing for complexity, IP theories loose in predictive ability.

Their main difficulty is that while they present a wide range of potential explanations for the way firms go abroad (thus answering the 'how' question of International Production), the treatment of the reason 'why' firms go abroad tends to be relegated into secondary considerations. Closely related to the 'where' issue, the 'why' question is indeed better grasped by IT theories.

Hence the necessity to combine IT and IP theories which suggests itself. Attempts have been of course proposed, starting with the most well-known eclectic theory. But several examples show how difficult it is to achieve a definitive stance in this respect. Lassudrie-Duchêne's framework for analysing the "International Division of the Production Process" (IDPP) is one of such attempt [Lassudrie Duchêne, 1982]. It addresses IDPP as a category per se, thus taking into consideration the distinct objective of international production aiming at production sites [op. cit.: 45]. Three modalities for carrying out the segmentation of the

production process are identified: association between firms (i.e., co-operative agreements), integration, and "impartition" on the market mode (firms relate to one another through market transactions) (...). The choice between these three categories is thus ascribable to an IP analysis. However, perhaps too hastily, ISC is classified within the latter category. Indeed, Lassudrie-Duchêne himself admits that the frontiers between these different categories of IDPP are blurred [op. cit.: 55]. But the most disappointing feature is that after having stressed the IP logic of IDPP, Lassudrie-Duchêne comes to the conclusion that IDPP is

"an ordinary expression of the international division of labor and of international specialisation" [Lassudrie Duchêne, 1982: 45],

thus resorting to an analysis in pure IT terms. It is indeed quite common to privilege one dimension at the expense of the other. An additional example is given by Germidis who, at the end of the 70s, considers that ISC is a good way for developing countries to specialize along the lines of their comparative advantages [Germidis, 1980: 10]. A slightly different shortcoming is illustrated by one study on ISC within the European Community done for the European Commission [Ravix, et al., 1989]. In its theoretical part, the report is well aware of the double dimension of ISC; but instead of searching for how best to combine an IP and an IT approach, both frameworks are rejected. On the one hand, the authors insist that ISC is distinct from integration, and refuses on this basis Michalek's category "D"; their argument is that the two logics are "completely opposed" as ISC is undertaken at market prices, whereas integration involves transfer prices. On the other hand, ISC is to be distinguished from banal relations of suppliers since the respective transactions involve goods in the latter case, and tasks or production operations in the former. Eventually, Ravix proposes to use Lassudrie-Duchêne's framework of analysis as an alternative paradigm without much enthusiasm; he ends up acknowledging his actual failure in identifying a relevant explanatory pattern for ISC [op.cit.: 38].

In the case of OPT

First, it should be stressed that the above shortcoming characterising IP theories in general have a specific salience in the case of OPT. gives rise to flows of international trade, while owing its existences to firms' strategies of relocation.

The insight gained from an approach to OPT in IP terms are connected to the fact that OPT is the result of firms' decision.

First, by answering the 'how' question of firms' foreign involvement, IP theories allow to determine the reason why firms go abroad using OPT rather than any other vehicle for organising international production. In other terms, IP theories are useful to identify the reason why OPT transactions do not happen on internal, but on external markets¹⁸⁸, i.e., why internalisation does not occur. Another way to express the same idea, the contribution of IP to the understanding of OPT consists in addressing the question of the relations existing between firms party to an OPT agreement in general, and the specific issue of the *control* that one firm may extend over its partner in particular: why an OPT foreign partner does not need to extend control over its partner, i.e., why does he not engage capital?

There are several possible answers.

Recent developments would point at new features characterising the world economy such as the definition of new modality of international competition requiring an adaptation of the old way of organising production. In short, OPT would respond to the necessity of acquiring more flexibility, or of reaping economic opportunities on a global scale.

Indeed, although of a traditional form, OPT responds to constraints imposed by the development of new methods of production, and new patterns of demand. Several studies highlight the transformation of the traditional sub-contracting relation, in both the national and international settings: from dependence to partnership¹⁸⁹, sub-contracting is more and more characterised by a "two-way" relationship [Mytelka, 1995]. Certain OPT agreements illustrate this point as they eventually culminate in the formation of a Joint Ventures between the foreign and the local partner. This approach solves thus what is an anomaly in the view of more traditional patterns of analysis.

The problem with these arguments is that they do not properly speaking identify the determinants of the OPT choice; they simply describe the advantages characterising OPT in a given context.

There are (complementary) explanations put forward by older version of IP theories which are more ambitious. In very 'eclectic' terms, for example, OPT firms do not undertake internalisation because there is no "appropriability of proprietary assets".¹⁹⁰ In other terms, there would be no transfer to operate because products concerned have no high content of firm-specific advantages. Fair enough, the statistical evidence presented in Chapter 3 confirms that the products involved in OPT transactions tend to be highly standardised, and, as a rule of thumbs, with a rather poor content of technological assets.

¹⁸⁸ The terminology is used in Casson (1976)

¹⁸⁹ See for example Baudry (1994, and 1993: 51). Altersohn, among others, relates the development of more equal partnership between contracting and sub-contracting firms to the characteristics of a post-taylorian economy (see Altersohn, 1992: 95).

¹⁹⁰ See Contractor, (1984).

A first immediate drawback proper to this line of argumentation is that any possibility of evolution tends to be ruled out: either an OPT partnership keeps on being based on the exchange of very rudimentary products in the absence of firm-specific assets, or it terminates as such. On the face of it, the results of the fieldwork presented in the previous Chapter showed that in a number of cases, there is a real possibility for upgrading banal OPT partnerships into more balanced and stable co-operations; indeed, it was argued that OPT and FDI can occur simultaneously.

But the problem with such IP explanations is beyond the appropriateness of the answers given to the internalisation question; it has very much to do with the fact that they simply explain .. what is not! Indeed, the empirical fieldwork made clear that, in sharp contrast with the above argument, to OPT can be associated quite extended degree of control even in the absence of capital involvement. In other terms, the risk of IP theories is that they fail to acknowledge other means of extending control than internalisation and capital involvement. There are, of course, notable exceptions. Oman (1988: 391), for example, notes that it is not the equity that makes the investment, and that vice versa, it is possible to have an equity involvement without the usual consequences associated with FDI: for example, control can be acquired through the use of bargaining power (see Root, 1988), or by the enforcement of contracts (see Buckley, Casson, 1985).¹⁹¹

The fundamental point illustrated by OPT is that yet another means for acquiring control, consists of 'exogenous' institutional factors, in general, and trade restrictions in particular. Indeed the above empirical evidence made clear that the latter render the arrangement particularly compelling, yielding a degree of integration which can compare with full internalisation: they create an ideal situation where foreign contracting firms find themselves in a very strong bargaining position. Being these advantages the products of the OPT arrangement provided for by the EU legislation, it turns out that, in the last resort, it is an institutional design that actually brings about the effects normally associated with internalisation. In short, institutional factors substitute for internalisation. As opposed to the eclectic framework, this view can account for two peculiarities of OPT: it gives sometimes way to eventual capital participation, and it might concern goods ranking relatively high in terms of value-added.

¹⁹¹ The literature on International Sub-Contracting activities present also some interest in this respect. As a matter of fact, it is considered that, while materialising through international trade flows, ISC nevertheless brings about "economic dependence", whether through contractual or ownership links.

4.3 Towards a systematisation of the determinants of OPT

1. The need for an ad-hoc explanatory patterns

In the following, an attempt is made to piece together the different insight gained subsequently from statistical and fieldwork evidence, and from relevant theoretical contributions. The objective is to answer the question of the prospective trajectories that OPT networks will follow, and their eventual contribution to the regional patterns of economic interdependence.

International Trade and International Production theories are only partially useful to assess and combine the market and institutional determinants forming the framework of constraint and opportunity identified in Part I.

Through a critical assessment of IT, it was made clear that 'comparative advantages' based on the availability of cheap and skilled labour are determinants of OPT insofar they are identified as such by policy makers who erect trade protection discriminating against local producers. That said, it is indisputable that cheap labour costs are essential in the decision to undertake and carry out OPT in CEECs.

As to the review of IP theories, it made possible to pinpoint the fundamental issue at stake in the OPT development, i.e., the question of the control extended on local firms. However, it was shown that IP theories seriously underrate the extent of the control extended by foreign firms on their local partners in the case of OPT.

The fundamental problem with such general determinants is that even if they are partially pertinent, they do not account for the actual variety of OPT patterns: they hardly explain country-variations, and they do not account for sector-specific features. In the following, an explanatory framework is proposed to determine the circumstances in which OPT gives way to the rationalisation of the strategies of foreign partners on the regional scale, and those in which OPT rather correspond to cross-border co-operations. This is done by piecing together the findings based on statistical data and fieldwork evidence.

Sector-specific determinants: the structure of trade protection

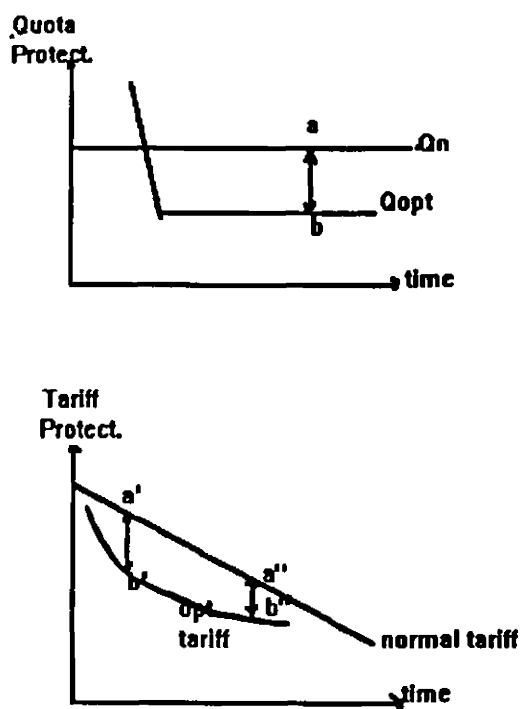
A primary factor accounting for the peculiar patterns of OPT in T&C is the structure of trade protection. As a matter of fact, OPT in T&C is likely to increase strongly because restriction measures on direct trade are binding constraints (Chapter 2). Having become fairly efficient and competitive, local firms which have often important production capacities inherited from Communist times, quickly fill up the quantitative protection measures still in place during the process of trade liberalisation. Thus, if they want to enter the EU markets, local producers have few other options than to engage into OPT partnerships with EU firms, a door purposely and acrimoniously left open to them. They can thus benefit from preferential market access under the form of additional 'specific' OPT quota.

In the other sectors, instead, the structure of trade protection is much less of an incentive to undertake OPT. As a matter of fact, these sectors are subject to a system of tariff protection, which is, as a general rule, less constraining and less irreducible than protection through quantitative protection: whereas there is no -legal- way to overcome a filled quota, there is always the possibility to pay a tariff in full. What is more the latter are rapidly decreasing in the context of trade liberalisation, whereas Chapter 2 shows a relative resilience of quotas pertaining to normal trade. As time goes, it thus proves to be more and more rational to pay a small tariff rather than to face relatively cumbersome administrative tasks.

One factor making the arrangement more attractive in the specific case of CEECs, however, is that the latter were granted a particularly preferential treatment under the form of a *complete* tariff cut on OPT transactions (as against a reduction in the case of other countries).

The following diagram summarises the respective incentive to undertake OPT depending on whether the good concerned is subject to quantitative or tariff protection. In Figure 1, at $t=0$, the gains obtained by undertaking economic OPT in sectors subject to quota, and that obtained by undertaking tariff OPT are ab , and $a'b'$, respectively. There is no reason, a priori, to think that one is superior to the other. But at times goes, as tariffs are being progressively lifted, the gain pertaining to the tariff regime decrease from $a'b'$ to $a''b''$. Eventually, whereas the structure of trade protection discriminate in favour of OPT until the very end when quotas are suppressed, incentives to undertake tariff OPT diminish over time.

Figure 1. The liberalisation of direct and OPT trade in sectors subject to quota; and the liberalisation of direct and OPT trade in sectors subject to tariffs.



Firm-specific determinants: size and competitive advantage

The fieldwork analysis listed numerous firm-level variables playing an important role in the structuration of OPT patterns between the EU and CEECs. One of these, the relative size of firms party to an OPT agreement appeared to be very important in determining the possibility for securing the long term commitment of foreign partners. As a matter of fact the cases corresponding to the possible consolidation of OPT were almost always involving big firms with important production capacities.

The number of partners is also a variable of importance. Diversifying the number of partners was shown to be a strategy which was not always successful. On the face of it, securing the commitment of one partner often yielded the upgrading of an OPT partnership.

Interestingly enough, the criteria of the number of partners appeared to be linked to the size of the local OPT partners. Smaller firms tended to have several partners, while their bigger counterparts were usually in a privileged partnership with fewer (if not one) foreign firms.

Finally, concerning the other firm-specific determinants of OPT, it is in their nature to vary from firm to firm. They fall into the category of the competitive advantage: possessing such an advantage is an important factor deciding upon the faith of an OPT partnership once wage differentials cease to be a driving motive for undertaking OPT.

Country-specific determinants: proximity and the starting point of the liberalisation process

Considerations pertaining to the proximity of the partner countries proved to be significant factors shaping OPT patterns. The geographical and cultural closeness of German and Czech partners is without contest an important factor explaining the quantitatively important and qualitatively diversified German OPT engagement in the former Czechoslovakia. The fieldwork found several examples where German were physically present on the production site.

Another variable is the chronological starting point of the liberalisation process. This factor favoured early German OPT activities in Hungary which opened its markets earlier. It is a factor which is also likely to have influenced the time horizon of the OPT strategy adopted. As a matter of fact, foreign OPT partners which started their operations under Communist times were likely to be initially driven by relatively short-term strategic considerations.

Finally, the industrial structure and the performance of the sectors concerned are also intervening variables. The good reputation of the Czech industry has certainly played a relevant role in this respect.

2. Synthesis: seizing the potentials for vertical quasi integration vs recovering independence

If pieced together, the above factors provide a framework for analysing the determinants of the trajectories of OPT networks.

Vertical quasi-integration

The sector-specific feature characterising OPT in T&C is due to the bindingness of quantitative restrictions which makes the recourse to the arrangement imperative. From the viewpoint of foreign partners, local firms' dependence on OPT places the former in an interesting position of power. The unparalleled merit of OPT in this respect is that it makes possible control without capital engagement. This is an important trait distinguishing OPT from

other more traditional forms of contractual agreements which allow to extend a minor degree of control.

Binding trade protection measures favour the vertical 'quasi-integration'¹⁹² of firms party to an OPT agreement in such a way that foreign firms can extend control over their local partners without engaging capital. In other terms, trade restrictions measures substitute for internalisation. Thus, such a vertical quasi-integration is a sort of ideal medium term between normal subcontracting and foreign direct investment, that combines at the same time the advantages of the two formula (the flexibility of entry and exit, and the control over the partner, respectively) while attenuating their inconvenient (the uncontrolled spill over of knowledge, and the financial cost, respectively).

Interestingly enough, these mechanisms are effective mainly with respect to the size of the firms party to an OPT agreement. As a matter of fact, big firms with important production capacities are the first to come against to binding quotas. They are therefore more likely candidates for vertical quasi-integration and for the eventual consolidation of OPT partnerships than their smaller counterparts.

Thus, the criteria of firm size reinforces the distinct attractiveness and effectiveness of tariff and economic OPT: resorting to OPT is all the more imperative for big firms in sectors subject to quota. On the contrary, small firms are less likely to be constrained by quantitative restrictions, and their decision to engage in OPT less 'dependent'.¹⁹³

It is also important to stress that vertical quasi-integration takes place only if local firms endeavour to secure the commitment of *one* privileged foreign firm (rather than to try to diversify partners), and if the latter occupies the major part of the local firms' production capacity. Such a dependence on OPT at the micro level is reflected in aggregate terms by the very high proportions of OPT in total trade.

Eventually, as trade barriers are being lifted, traditional means to extend control are likely to be adopted. Overall, the structure of trade protection together with firm-level variables like the size of firms party to an OPT agreement, account for the development, on the basis of OPT, of more durable forms of a vertical division of labour at the regional scale in the sector of textile and clothing.

¹⁹² The term was first coined in (Houssiaux, 1957) to denote sub-contracting activities in a national context. Subsequent theoretical developments were carried out in (Horst, 1972).

¹⁹³ Unless the small firm produces items that are constrained, because, for example, a big firms already fills up the available authorised quantities.

Cross-border co-operation

In other sectors where trade restrictions are not such a factor rendering the arrangement particularly decisive for accessing EU markets, the potentials for quasi-vertical integration are lower. Thus, the mechanisms of OPT are less effective in fostering the vertical division of labour at the regional scale.

If factors favouring the quasi-vertical integration of firms party to an OPT agreement are less effective, this is not to say, however, that they are entirely negligible. Here again, much depends on the size of the firms concerned, and durable partnerships are more likely to develop on the basis of OPT between big firms. As a matter of fact, a big firm has more means to actualise the potentials for quasi-integration, be it only because it is capable to order bigger quantities, and, in this way, to fill the production capacities of its local partner more thoroughly. To some extent, this implies that the local partner is also more likely to be big, and thus able to comply with the demand. As a matter of fact, OPT goods are mostly labour-intensive and associated with standardised production processes. Chances are that foreign partners will want to take advantage of economies of scale, and thus look for big local partners.¹⁰⁴ In this respect, firms from CEECs are indeed quite interesting as they often have inherited huge production capacities from Communist times.¹⁰⁵

To compensate for the lower effectiveness of trade restrictions in securing vertical quasi-integration, however, additional conditions must be fulfilled. Being in possess of a competitive advantage under the form of a particular infrastructure or a specific skill acquires a decisive relevance in this respect.

By contrast, smaller firms are more likely to use OPT as a carrier for their workbench activities in neighbouring countries. In this case, country-specific factors like proximity and industrial performances are of crucial determinant of OPT patterns. Interestingly enough, in this case, proximity might be -for some time- enough to off-set increasingly unfavourable wage conditions. In this view, foreign partners are likely to stick to their engagement provided that the advantage of distance compensates for increasing wage levels.

This result thus contrasts with traditional views on 'workbench' activities considered to be relatively footloose: if SMEs do not have a regional outlook and devise their strategy on a strict bilateral basis, this is not to say that they do not have a relatively long-term time horizon.

¹⁰⁴ This is of significance as far as the contribution of OPT to the foreign involvement of Small and Medium Sized Enterprises is concerned: it shows that SMEs are likely to be marginal in OPT operations, and not only because they tend to be characterised in general by lower degree of involvement abroad.

It is also in contradiction with the hypothesis of successive waves of 're-relocation' in countries further East where wages are still lower.

Overall, in the sectors where trade restrictions do not warrant an almost automatic upgraded commitment of foreign partners, OPT corresponds both to the regionalisation of big firms' strategy, and to the cross-border activities of SMEs. Size and competitive advantage appear to be decisive criteria in the development of upgraded partnerships on the basis of previous OPT relations, whereas country-specific variables weigh comparatively more in the case of OPT activities of SMEs.

3. Empirical validation

The results of the fieldwork presented in Chapter 3 show that there are two escape routes available to local firms which have come to be significantly dependent on foreign partners: to take-over OPT production on their own, or to induce foreign partners to upgrade their engagement. It was found that the two possibilities have different chances to be successful depending on the host country and the sector concerned. In textile and clothing, what is at stake is to secure the prolonged commitment of foreign partners. In the other sectors, Hungarians are better at taking over production on their own whereas the Czechs rely on upgraded OPT partnerships.

A few features highlighted in the fieldwork study might help illustrate the general explanatory pattern of such stylised facts.

The former Czechoslovakia vs Hungary

Recovering autonomy was the less frequent scenario among the firms visited in the Czech Republic. Only one firm in the textile and clothing sector, TIMO, managed to disentangle from OPT by taking over production on its own. On the face of it, ONA, a small firm also in the T&C sector is a contrasting example which is more representative of the general trend at stake in the OPT business in the Czech Republic. Because of the reduction of OPT, the firm had to reorient its sales to the less demanding local markets which is rather a forced outcome than a deliberate policy.

A striking point is that almost all the firms interviewed in the Czech Republic were contemplating the possibility of increasing their OPT contacts with foreign partners. If OPT partners and proportion were actually decreasing, it was always considered to be an undesirable state of affair. One such examples is given by VUOSO; it illustrates how resorting to OPT is

made almost compulsory by the extreme difficulty to undertake independent exports. VUOSO's experience is the most positive. It shows that even though having recourse to OPT was a highly constrained choice, the firms managed to ascertain some kind of bargaining power thanks to a competitive advantage based on the use of research-intensive resources. It is also an illustration of how a competitive advantage might represent an asset playing in favour of smaller firms which substitutes for production capacities (see below).

It is also interesting to note that the OPT networks identified as potential candidates for emerging Cross-National Production Networks develop in sectors relatively 'new' in terms of both the orientation of their sales to Western markets and their initial dependence on OPT. The Czech industries of electrical machinery and footwear used to give rise to relatively marginal amounts of total and OPT exports to the EU in 1991.

On the contrary, in Hungary, sectors already significantly dependent on OPT in 1991 are generally marked by strong decrease of OPT without sign that foreign partners had upgraded their commitment. The crucial question, in these cases, is whether independent exports can take over OPT trade.

Firm size

In the T&C sector, OP-Prostejov and Styl are two straightforward examples of the importance of the size variable. In the case of OP, the size of the firms appeared to matter, not in the absolute, but indeed in connection to the size of the firm: because its immense production capacities are easily constrained by the trade barriers imposed by the Community, OP clearly depends on OPT if it wants to survive as such. Hence the potential for vertical quasi-integration reaped by its main partner, Hugo Boss. On the face of it, smaller firms which are less likely to be constrained by quantitative restrictions, appeared to be less 'dependent' on a stable partnership with foreign firms.¹⁹⁶

Competitive advantage

The fieldwork also illustrates how local firms presenting some attractive assets beside their advantage in terms of labour costs were in a more favourable position to secure long-term relationships with a foreign partner. Such 'assets' are of different natures. In first place, local

¹⁹⁶ Unless the small firm produces items that are constrained, because, for example, a big firm already fills up the available authorised quantities. Conversely, when the preferential trade treatment attached to OPT consists of a partial or a total relief of tariff duties, OPT is probably more valuable for small firms: affording to pay tariffs is more difficult for them as they are likely to be poorer in capital than bigger firms.

partners should possess a competitive advantage like specific skills, the ability to master complex tasks, the possession of the required machinery, or a particular infrastructure or investment. On this point, the outcome is shaped on a firm-to-firm basis: Vuoso's competitive edge in a specific technique, and CKD's infrastructure are two illustrations.

Number of partners

The interviews showed that the foreign firms which were the more incline to upgrade their commitment were systematically the unique partner of a local firm: a high proportion of OPT in total production with *one* foreign partner was almost always associated with declared long term partnerships. On the contrary, when local firms had various partners, each of them occupying only a marginal proportion of the local firm's total production capacities, the latter tended to be less committed and thus more sensitive to wage increases.

The case of CKD-Elektrotechnika is the most telling illustration of how an OPT partnership can be so stable as to compare with foreign direct investment. It shows that for quasi-integration to take place, and thus for long-term partnerships to be secured, only one foreign partner must occupy the majority -if not the totality- of the local firms' production capacities. On the contrary, the example of Vilati, the Budapest-based electronic firm illustrates how local firms engaged with several partners, have a more precarious existence; it is an example of how local firms might "specialise" durably into OPT activities, on a basis which is, actually, quite fragile.

Of particular interest is the classification of its partners by Vilati into 3 categories: 1) stable partners which are necessary to give a long term horizon to the firm's strategy, and thus for it to invest; ideally, they should account for 80% of the total number of partners; 2) the occasional partners (around 20% of the total number); 3) the potential ones. These latter are very important for Vilati to keep up with the nature of the demand addressed to sub-contractors; it is also the only way for Vilati, which has almost no product under its own trademark, to promote its capabilities. The first group consists of big foreign firms, whereas small firms have more chance to resort occasionally on OPT, and thus to belong to the second group. As to the very big firms, they rather invest in a greenfield plant, as they have at their disposal the necessary capital.¹⁷ It means that partners of the first group are not necessarily prone to invest in the local firm: they are just big enough to have market shares.

4.4 Conclusion

The present Chapter shows the relative inadequacy of both International Trade and International Production theories in accounting for OPT. Because OPT gives rise to flows of international trade, while owing its existence to firms' strategies of relocation, it was expected that a combination of IT and IP theories would have provided satisfactory insight on this specific type of market linkage. In fact, the drawbacks of one approach are hardly corrected by the contribution of the other, and the contributions themselves are often not in line with the available empirical evidence.

Hence, the Chapter proposes an alternative ad-hoc explanation of the trends followed by OPT trade observed in the statistical analysis, and of the features characterising OPT partnerships identified by the results of a fieldwork and presented in Chapter 3. It assessed the respective weight of institutional variables, country-specific variables and firm-level factors as determinants of the terms under which OPT contributes to the patterns of economic interdependence between the EU and CEECs.

In general, the OPT case illustrates that the very process of trade liberalisation is potentially one powerful instrument shaping the patterns of trade and production specialisation. Its form (the specific measures, like OPT, lifting trade barriers), and its pace (the length of the transition period during which trade obstacles are still enforced) have an impact which impinges durably on the division of regional labour.

In the specific case of OPT in T&C, the structure of trade protection (quantitative restrictions) is an important determinant of the dynamics of OPT trade. It accounts for the distinct evolutions undergone by the T&C sector, and the other sectors subject to tariff protection, respectively. Thus, the structure and the nature (the bindingness) of trade restrictions favour the vertical 'quasi-integration' of firms party to an OPT agreement where local producers present the most serious competitive threat. In turn such vertical quasi-integration possibly paves the way for the establishment of a more durable vertical division of labour at the regional scale. Indeed, the potential for quasi-integration is an incentive important enough to induce foreign firms to undertake OPT on bases which are sounder, less volatile than if low wages were the only motive for undertaking OPT.

In the other sectors, insight gained by an analysis centred on the firms and the partner countries explains why OPT has lower probability to spur relatively durable and complex forms of co-operation between local and foreign firms. In this case, the use that SMEs make of the arrangement to organise their 'workbench' activities is determined by factors characterising host countries like proximity and openness.

Overall, the wide range of OPT determinants accounts for the highly variegated patterns of OPT between the EU and the CEECs identified in the previous Chapter.

III/ Globalisation, Europeanisation and the governance of the economy

On the basis of the two previous sections which aimed at dissecting the 'mechanics' of the OPT arrangement, the present part attempts to infer the general significance of the very specific, and indeed tiny OPT story. What are the general issues at stake in the above analysis of the ways in which OPT patterns have been developing between the EU and the CEECs?

The starting point of the analysis is the observation that OPT is a contrivance adopted by national policy-makers in order to make possible the relocation of production by home firms in sectors where protectionist measures would in principle be an obstacle to such a strategy. In other terms, OPT is originally conceived as a national response to the globalisation of production activity in certain sectors.

Devising an OPT policy at the national level came to involve the mechanisms of the European integration process. On the one hand, diverging national OPT regimes had to be harmonised thus paving the way for the deepening of the Community competence. On the other hand, the OPT arrangement is part of the current process of trade liberalisation between the EU and the CEECs, expected to culminate in the enlargement of the Community. Hence, the OPT case is at the nexus of the deepening and the widening dimensions of the European integration process.

The main argument on which the present section rests is that the OPT story testifies to the reason why and the way in which the European integration process develops. It is proposed in the following to make the most of the fact that OPT is useful for understanding how 'Europeanisation' and globalisation interact.

Chapter 5 is intended to make clear the conditions under which the European integration process might indeed provide an effective response to globalisation. The recourse to various theoretical backgrounds on regional integration in general, and on European integration in particular suggests that the process is flawed by several apparent shortcomings. In the conclusion Chapter, a key for interpreting such ambiguities is given. The OPT story actually tells about the establishment a European system of governance of the economy that traditional views on the political control of economic activity fail to acknowledge as such.

Overall, the OPT story illustrates how globalisation affects the use of traditional tools of policy-making, and, beyond whole conceptions of governance of the economy. It exemplifies the way in which (and the scale at which) the political control of economic behaviour is redefined under the pressure of the globalisation of firms strategies.

Chapter 5. Deepening and widening: the European answers to globalisation

The study of the contribution of OPT to the European integration process is interesting for addressing the topical issue of the relations between 'Europeanisation' and 'globalisation'. Indeed, it was shown in Chapter 1 that OPT measures were adopted first by national authorities, and then at the Community level under the pressure of business strategies of firms reorganising their production activities beyond national frontiers: 'gate keepers' [Strange, 1991] thus redefined classic trade protectionist measures making it possible for firms to take advantage of 'global' opportunities while keeping the process under close (political) monitoring. The fact that such a process involved not only the national level of action, but also the European integration mechanisms means that, whether directly or indirectly, 'Europeanisation' develops in connection with 'globalisation'. The present Chapter further investigates the nature of the response to globalisation adopted at the European level.

Interestingly enough, it appears that the OPT story actually makes sense with respect to both the widening and the deepening dimensions of the European integration process. On the one hand, OPT is an example of the difficulty to effectively transfer competence from the national to the supranational level; on the other hand, it illustrates the terms under which economic interdependence between CEECs and EU countries is currently taking place. Hence, the OPT contribution helps understand under which conditions the framework of opportunity and constraint within which firms take their decision is 'europeanised', and with what consequences on the actual organisation of economic activity. In very short, it makes clear which authority, whether political or economic, takes what measures and decisions, and with what effects on the patterns of East-West economic interdependence.

In this first approach, how OPT is enmeshed in the mechanisms of the Community's widening and deepening processes will be analysed separately. But the final Chapter will show how these two developments illustrate the mechanisms of a sui-generis system of governance of the wider European market economy.

5. 1. OPT and Deepening: the Europeanisation of the framework of constraint and opportunity

As shown in the first part, the adoption of OPT measures interfered with the Community institutions and arrangements. In the Textile and Clothing sector, where national governments have traditional prerogatives in the provision of quantitative restrictions, the necessity to

harmonise diverging national regimes potentially strengthened the competence of the Commission. However, the definition of a common position on OPT proved to be extremely difficult. In the other sectors subject to a system of trade protection already agreed at the Community level (the Common External Tariff), the centralisation of competence at the European level was in principle already a reality.

In fact, no effective centralisation of competence at the Community level occurred, either because the potentials were not seized (in T&C) or because the Commission did not use the competence it was endowed with (in the other sectors). Thus, even if it was its natural development, the OPT policy did not give way to the deepening of the European integration process. Overall, what is at stake in the whole endeavour is the effective 'Europeanisation' of the framework of constraint and opportunity within which European firms adopt their OPT strategies.

In this section, it is proposed to fully draw the implication of the OPT story for understanding why the European integration process could have deepened as a result of the OPT policy, but actually did not. Indeed, the evidence in Chapter 1 is particularly illuminating as far as the driving force, the mechanisms ... and the main obstacles encountered on the course of the process are concerned.

The OPT contribution concerns at least three issues:

- the reason triggering the European integration process
- the mechanisms whereby the process develops (the "type" of policy-making to which OPT legislation-making is ascribable)
- and the eventual outcome achieved.

1. Launching the policy-making process

The above empirical account is telling as far as the factors triggering the whole process of OPT legislation-making in T&C are concerned. This is useful to disentangle between contrasting approaches to European integration. Two paradigms claim some pertinence in this respect. In very rough terms, whereas a neo-functional interpretation would put forward the notion of "spill-over" for explaining the extension of Community competence, and therefore the definition of new supranational policies at the expense of national policy-making,¹²⁴ neo-realism

¹²⁴ The founding reference is Ernst B. Haas's *Beyond the Nation-State* (1964).

believes that the involvement of the supranational level of decision is always done in harmony with the interests of member states, if not at the very instigation of the latter.¹⁹⁹

What the above example tends to show is that the intense legislative activity at the European level is mostly ascribable to the *necessity* of harmonising diverging national regimes. It is the existence of a Common trade-policy, and the objective of the Single European Act which made the Commission's endeavour inevitable. This very much recalls the nature of the integrative mode highlighted by the neo-functionalist school. In this interpretation, Community institutions and arrangements already in place give inevitably way to the further strengthening of competence at the supranational level in related area. Thus, the advance of integration in the field of trade policy as embodied in the provision of a Common External Tariff and the implementation of the Single European Act, spilled over to the connected area of the adoption of specific quantitative restrictions.

Several arguments actually mitigate such a 'pure' neo-functionalist approach. For a start, it is worth noting that the very origin of the OPT story at the European level has to do with the adoption by national authorities of incompatible and competing policy stances on how to challenge international competition, with a resulting strong risk of competition between the different OPT regimes²⁰⁰ at work throughout the EU countries. One possible interpretation is that certain member states favoured the adoption of the Community harmonisation policy in order to reduce the threat of being taken over by the Germans in the promotion of industrial competitiveness (and the subsidisation of job exports). They thus accepted the erosion of their competence with the objective of turning the Community arrangement into an instrument for keeping under control the policy orientations of their German partners. Thus, an intergovernmentalist flavour complements the above straight neo-functionalist interpretation: in the last resort, harmonisation was rendered necessary by factors making sense at the national level, and if the process could actually take place, it is because member states were willing to accept it.

However, this is not to say that the process was *deliberately* triggered at the instigation of member states; the initiative of the process is indeed a point of contention where the neo-functionalist approach can still claim some superiority. If member states tried to turn the process in their favour (see below), they did not necessarily and deliberately triggered it. For instance, in the previous empirical account, it is difficult to envision why the British government, one of the early most virulent opponent to the arrangement, would have gone spontaneously to Brussels in order to recover an hypothetical loss of competence in economic matters at the national level. On

¹⁹⁹ For the 'scanning' of the neo-realist approach, see Marks et al. (1996: 3).

²⁰⁰ The notion of "regime competition" is at best controversial if anything because of the indeterminacy of the significance of the term. See Strange (1994).

the face of it, it seems indeed credible to contend that, confronted with the necessity of harmonisation as imposed by the Community, the British government, and the other most hostile actors to the OPT liberal leaning, did their best to render the process compatible with their own policy priorities.

In this view, it is therefore *once* harmonisation took place that member states went to Brussels with the intention of using the European forum for dealing with the risk of regime competition. Recourse to the European level is thus not the result of the initial deliberate intent of member states. The intergovernmentalist and the neo-functional explanatory patterns should be carefully handled and combined.

2. Developing the process

The story of the way the process, once triggered, actually develops is another one. What is at stake is a move towards the potential centralisation of competence from member states to the Community level. As described, the way this result is obtained is through harmonisation i.e., the definition of policy guidelines precise enough to be applied uniformly throughout Member states. Thus, willy-nilly the process is supposed to bring about the transfer of competence from the national to the supranational level.

National vs. supranational extension of competence

The empirical part shows that member states actually managed to preserve most of their prerogatives in plain contradiction with the predictions of a neo-functional approach. Hence for some reason, at some point, a very initial neo-functional starting point notwithstanding, the process turned out to develop in conformity with the interests of member states.

The 'technical' reason accounting for such an outcome is depicted in the description of the legislation-making procedures in Chapter 1: the politics of 'deliberate vagueness' consists in maintaining (if not favouring) the unintelligibility of certain provisions in order to make the harmonisation endeavour of the Commission inefficient.

Theoretical approaches to the European integration process might prove of some help to go beyond the mechanics of such an outcome, to its actual meaning. The way the OPT story develops gives credit to both the interdependence and the intergovernmentalist schools which consider that the European integration process eventually profits member states. But the above empirical approach shows that none of them offers a truly satisfactory account of the reality.

According to the proponents of the interdependence school, for example, the way national authorities take advantage of the European integration process has a price in terms of the preservation of their competence: they actually irredeemably lose certain of their prerogatives that they recapture, under an altered form, only at a second best supranational level. On the face of it, in the intergovernmentalist model, the national level of action is indeed, in the last resort, considered to be adequate: going at the supranational level is instrumental in serving national authorities' interests. In other terms, according to the intergovernmentalist analysis, the national level of action is eventually strengthened, whereas the interdependence paradigm pinpoints the effectiveness of the centralisation of competence, even if this results from the express objective of member states.

On this simple basis, one would conclude that the intergovernmentalist account fares better than the interdependence explanation. Indeed, the latter is characterised by a double shortcoming²⁰¹: not only there is not much competence extended at the supranational level ... but there is not much prerogatives lost at the national one either. Instead, the intergovernmentalist is closer to the point concerning the final outcome, i.e., the strengthening of the national level at the expense of the Community development. However, even the intergovernmentalist approach is imperfect. First, as previously suggested, soliciting the Community level of action does not result from member states autonomous initiative: they do not appear to go voluntarily on the Community arena to recapture what they have hypothetically lost at the national level. What is more, nothing much happens in *effective* terms at the Community level. Whether pulled unintentionally or whether they are consenting, member states do not properly speaking use the mechanisms of the European integration in their favour: they just block their development at an early stage.

The overall lesson to draw from the above analysis concerns the partial irrelevance of the theories of European integration. Each of them contains a parcel of pertinence, each of them consists of a large part inadequate for depicting the OPT story. The interdependence explanation is the most easily discarded; its pertinence in the case of OPT consists (only) in accounting for an ideal state of affair, that would have occurred, were the process have developed as expected. Indeed centralisation of competence at the European level is one solution to growing economic interdependence.

The most serious candidates are thus the neo-functionalist and the intergovernmentalist models. However, none of them provide a complete set of explanations. This is an invitation to pick up and combine the most pertinent parts of each approach. But it is to be done carefully, as the two paradigms are indeed in principle incompatible. One way to distinguish between them is

²⁰¹ The interdependence interpretation which would rather corresponds to an hypothetical state of affair (see below).

to refer to the direction of the process of competence devolution. In the words of Hollingsworth, an intergovernmentalist process corresponds to 'the upward delegation' of competence from the national to the supranational level: Thus in a dialectical vein, sovereignty is sacrificed in order to be restored. On the contrary, still according to Hollingsworth's viewpoint, the neo-functionalist interpretation illustrates the 'downward authoritative modification of national regimes by international regimes' with harmonisation²⁰² the instrument for implementing mandated convergence [Hollingsworth et al. 1994: 292].

The OPT example shows that there is a strong premise ascribable to the latter logic, but that the actual outcome is in fact in conformity with the former approach: factors initiating the OPT policy-making process at the Community level are fairly identified by a neo-functionalist approach, but intergovernmentalism rightly predicts the way in which the process eventually benefits the national level of action. What happens in between ... is better grasped by a sui-generis interpretation of the OPT case.

The question of the 'type' of Community policy-making

Despite the above difficulty to ascribe OPT policy-making at the European level to one unique theoretical framework of interpretation, some analyses have attempted to characterise the 'type' of policy-making in T&C thus assuming de facto that a transfer of competence actually took place. Specific traits which are the most referred to are: corporatism and interventionism [Farrands, in Wallace and al. 1983: 314...]. The example of OPT somewhat tempers this view. It was indeed shown that representation through European Confederations despite the traditional strong bargaining clout of COMITEXIL was in this case particularly ineffective. On the face of it, firms had to rely on their government to be represented. In some (exceptional) cases, however, big firms chose the Brussels route and brought pressure to bear directly on the Commission without any intermediation. In this respect, the role played by the Commission is crucial. Indeed, it is considered that in T&C in general, and in the specific case of OPT,

"policy-making is overwhelmingly intergovernmental (...) yet the Commission's interventions are substantial" [Ibid: 315].

²⁰² What might seem inappropriate in this dichotomy applied to the OPT case is that harmonisation is considered to be at work only in the second mode of competence shifting. On the face of it, the proponents of the first view could very well integrate the notion into their explanatory pattern as well by arguing that harmonisation comes only second after the decision of member states to resort to the supranational level.

In fact, the empirical evidence of Chapter I shows that even though the Commission is, in the last resort responsible for the legislative endeavour carried out at the European level, it does not act autonomously.

What is more, in the face of the missed centralisation of competence at the European level, it seems relatively vain to try to qualify what is only a 'virtual' process. This has a first implication as far as the use of concepts traditionally applied in the case of domestic politics [Hix, 1994]. In this context it is indeed no use to ask whether EU policy-making is rather pluralist or, on the contrary, whether it responds to mechanisms proper to a neo-corporatist model. An additional reason why it does not really make sense to try to specify one type of policy-making to characterise the whole set of policies engaged at the Community level is that indeed, the answer varies to a high extent from policy area to policy area.²⁰³ Overall, in the OPT case, the failed centralisation of competence, and the still prevalent influence of member states in the policy-making process invites to use concepts proper to the theory of International Relations or even more convincingly *sui-generis* analyses.

In this respect, Greenwood's "disaggregated approach to the study of interest intermediation" seems particularly adequate for tackling the difficulty [Greenwood, et al. 1992: 18]. It is also very much in line with notions developed recently like 'multi-level policy-making'²⁰⁴, or 'multi-level system of governance' [Marks, 1993]. It similarly fits with Greenwood's injunction to distinguish between a series of 'policy communities'²⁰⁵ at the European level [Greenwood, Ronit, 1994: 35]. Finally, Streeck (1991), talks of 'disjointed pluralism', and 'competitive federalism' which does not apply to the European policy-making style in general but rather denotes various possible types at the Community level.

An integrative mode at stake: harmonisation

The above OPT story is useful to draw some insight on one way the European integration deepens i.e., on one of its 'integrative mode': harmonisation.

According to a traditional distinction 'negative integration' takes place under the form of deregulation, defined as

²⁰³ To use the pertinent formula put forward by Lowi, 'policy makes politics'.

²⁰⁴ Puchala, quoted in Wallace (1983: 406).

²⁰⁵ Heritier uses a similar notion using another terminology: policy networks. See Heritier (1993). See also Peterson (1995), and Scharpf (1993) quoted in Risse-Kappen (1996).

"the emergence of interdependencies in the process of economic integration without 'spillover' into simultaneous growth of regulatory institutions capable of controlling them" [Streeck, 1991: 135],

whereas 'positive integration' amounts to the establishment of regulatory regimes at the supranational level pre-empting national legislations. This distinction corresponds roughly to the opposition between harmonisation and mutual recognition as two different integrative modes. At first sight, OPT is an illustration of the former. However, because of the very ineffectiveness of the regulation eventually adopted, there is no supranational implementation of regulatory capacity ... and the national regimes are not effectively pre-empted. In short, OPT validates the outcome achieved through a process of negative integration while being clearly ascribable to a logic proper to the positive mode.

Interestingly enough, Majone ascribes to 3 possible causes to 'over-regulation' which are to be mitigated on the basis of the OPT empirical evidence: the paucity of financial means of the Community budget²⁰⁶, the willingness of the Commission to assert its power, and the preference of MNCs to act within an harmonised environment throughout Europe [Majone, 1990]. As argued, harmonisation was a necessity, intended in a very neo-functionalist vein, almost automatically flowing from the very existence of other policies adopted at the Community level. It is indeed not the result of the Commission's deliberate intent to strengthen its own prerogatives (nor is it successful on this matter, anyway). As to MNCs' pressure, it was shown that they played quite an important part in the decision-making process; but the primary reason for MNCs' participation has probably more to do with their favourable stance vis-à-vis liberalisation than their concern to be confronted with similar conditions, whatever these latter might be. What is most interesting in the argumentation of Majone is his scepticism concerning the eventual outcome of the process. Indeed, in his interpretation, harmonisation is deemed to lead to over-regulation; this is the reason why the Commission changed its policy orientations and favoured the mutual recognition approach, a much less costly integrative mechanism. This is indeed validated by the OPT example.

The above insight are not necessarily good news as far as the European integration process is concerned. As a matter of fact, if

"in practice much of what can be termed European integration is in fact about regulation" [Mazey, Richardson, 1993: 254],

²⁰⁶ P. Schmitter would agree for whom regulation is a major resource to institutions when they have only a limited budget at their disposal (quoted in Mazey, et al., 1993: 254).

and if regulations at the European level acquire only limited bindingness over national regulation, as it happens to be the case of OPT, then the process of integration is necessarily of limited success.

3. Process achievement: a potential industrial policy at the European level

What is at stake in the above account is the missed opportunity to design an industrial policy at the European level. Indeed, the OPT case presented all the potentials for placing in the hands of the Commission a powerful instrument of industrial policy.

To be sure, the OPT arrangement is originally supposed to satisfy to trade policy imperatives. However, as illustrated above, the first regulation dealing with economic OPT already contained some overt elements of industrial policy. This is so, for example, of the necessity for eligible products to be of Community origin, a provision introduced by the 1982 legislation which is indeed loaded with important industrial implications.²⁰⁷ The same can be said of the necessity to be a producer with facilities located within the Community. Subsequent negotiations destined to harmonise the application of the regulation throughout member states even accentuated these nascent elements of industrial policy. As a matter of fact, the opposition between member states using the OPT text as an instrument fostering international competitiveness and those willing to use the arrangement for preserving employment in the Community placed issues of industrial policy at the core of the debate. Thus, from a typical trade policy measure, OPT has come to be an instrument for choosing between two objectives which relevance has clearly to do with industrial policy matters.

That trade measures might be used intentionally as an instrument of industrial policy, or simply that trade measures entail unintended consequences on the organisation of industrial activity is nothing new. What is particularly interesting in the OPT case is that the process is coupled with a simultaneous potential transfer of competence from the national to the supranational level.

But the *potentials* were indeed not seized. Whereas member states were particularly aware of the underlying implications of the legislation in industrial-policy terms, the Commission remained exclusively focused on the objective of harmonising trade conditions in strict technical terms.

²⁰⁷ By contrast, recall that the tariff OPT concerns all goods placed in free circulation, irrespective of their origin.

5. 2 OPT and Widening: the political underpinnings of the regional division of labour

The OPT story is not only relevant for understanding how effective the deepening of the Community is in providing a 'europeanised' framework of opportunity and constraint. As shown in Part II, OPT is also one important determinant of the terms under which regional economic integration takes place. At the same time a policy response to international competition, and a factor contributing to the widening process, the OPT example thus suggests how the enlargement of the Community owes part of its *raison d'être* to globalisation.²⁰⁸

The OPT case is telling as far as the underlying logic and the actual outcome achieved by the process of enlargement are concerned. Beyond, it is interesting in the context of the multiplication of regional co-operation schemes between areas at different levels of development. Thus, the European enlargement process can be considered to be a useful case study highlighting the specificity or, on the contrary, the exemplarity of the latter.

In a similar vein to the previous section which focused on the contribution of OPT to the deepening process, the present part aims at gauging how effectively the widening process develops in the context of the internationalisation of EU firms' production activities: what is exactly the nature of the response to the pressure of globalisation proposed by enlargement and what is the outcome achieved?

1. Theoretical contributions on regional integration

There are several topics addressed the literature on regional integration which can provide useful guidelines for making sense of the issues at stake in the OPT story. One important characteristic of such a body of literature is its highly eclectic composition, directly ascribable to the ill-defined notion of 'integration'. There are indeed various forms and multiple dimensions to the phenomenon which invite to adopt as many perspectives. Possible categorisations would distinguish economic vs political, regional vs international, microeconomic vs macroeconomic,

²⁰⁸ In fact, enlargement is rightly and commonly considered to be an issue ascribable to the sphere of high politics. But if one is to fully understand what the eventual political shape of the European continent will be, it is necessary to bring into the picture the terms under which economic interdependence develops between the two areas: how exactly Central and Eastern Europe fits into the regional division of labour is no less determining than security issues in this respect. Hence the two dimensions should not be held separate: if anything, in the name of the indeterminacy relative to the sense of causation. An interesting approach to how security matters and economic transactions interact is in Bertsch, Vogel, and Zielonka (1991).

vertical vs horizontal, de jure vs de facto integration ... etc [Panic, 1988]. If anything, this testifies to the range of the issues at stake in regional integration. Broadly speaking, there are two strands of approaches ordering such issues: a first one is concerned with the different possible forms regional integration can take, whereas the second one is more interested in the consequences of the latter. Of course, the two series of developments are not exclusive.

In the following, a review of the literature will select the most relevant approaches and assess the insight they bring into the OPT story. As in the case of similar previous exercises, it will be shown that by confronting the OPT empirical evidence with pertinent theories much can be learnt from OPT in a feed-back process.

Different stages

A predominant approach considers economic integration to be a process rather than a state; a first question has therefore to do with its different *stages*, and the evolution from one stage to another. As a matter of fact, first analyses were taking place in parallel with the formation of the European Community, which underlying normative principles of development, mainly formalised in Jean Monnet's doctrine, inevitably influenced the former [Machlup, 1977]. In 1961, Balassa proposed his dynamic approach to regional integration, with the identification of at least four forms representing various degrees of integration: free trade area, custom union, common market, and the formation of an economic union. Eventually, the process yields complete economic integration [Balassa, 1961: 2]. It is not explicit, but Balassa treats these different forms of regional integration as if they were taking place in a chronological order; after having progressively gone through such different stages, the process culminates in an all-encompassing political integration translating into the enforcement of the principle of supranationality.

A slightly different interpretation of the stage approach to regional integration consists in distinguishing between positive and negative integration [Tinbergen, 1954:77]. Indeed, integration can be more or less strong depending on the degree of centralisation of economic policies. Whereas during the 'negative' phase of integration, all the barriers to exchange are removed, the positive stage sees the implementation of common economic policies. This second view corresponds to Balassa's account of the opposition between 'liberalist' and 'dirigist' ideals of economic integration: the former is limited to trade liberalisation, the latter has to do with co-ordination (not necessarily in the context of lifted trade barriers) [Balassa, 1961: 7].

Finally, an additional version of a stage approach to integration rests on the distinction between 'shallow' and 'deep' integration [UNCTC, 1993]. In this case it is referred to the difference between the integration of trade and that of international production activities; although it is now acknowledged that the two go hand in hand [Julius, 1990], there might be a

short laps of time with trade integration preceding the development of the interpenetration of production activities on a regional basis.

Different arrangements

More recent developments tend to set aside a view in terms of chronologically ordered stages: the emphasis is rather placed on the difference between the various forms of regional integration schemes, characterised by distinctive substantial traits that do not necessarily evolve towards a homogenous outcome. One area of research is, for example, the difference between free trade areas and custom unions.²⁰⁹

This second kind of approaches is a prerequisite before tackling the other big issue at stake in the theory of economic integration: the welfare consequences of integration.²¹⁰ Viner, a definitive reference in this respect, elaborated on the seminal distinction between the notions of trade creation and diversion [Viner, 1960]. Whereas the former yields an increase of welfare, the latter leads to the opposite result; overall, the effects of integration remain indeterminate. Although such a result seemed quite robust, an impressive numbers of studies tackled the same question, without any major theoretical breakthrough. Some of the most important contributions are presented by Massell (1965) who concluded that there is always a non preferential trade policy superior to the Custom Union option, by Corden (1972) who introduced the notion of economies of scale in the study of regional integration, by Johnson (1965) who modified the definition of welfare traditionally adopted, and by Kemp and Wan (1976) who reached the conclusion that a custom union is always beneficial provided that the Common External Tariff is fixed in such a way as to leave unaffected trade with the rest of the world, whereas intra-member trade is enhanced²¹¹ [Cline, 1994].

Several critiques can be addressed to such developments²¹², but their main weakness is probably their almost exclusive focus on static considerations. As a matter of fact, and as suggested by Balassa quite early, it seems unrealistic to neglect the dynamic consequences of regional integration which are probably more important than the static welfare effects [Balassa, 1961]. Different analytical tools can be used for doing so, in particular, the assumptions of monopolistic competition and oligopolistic market structure, as well as developments concerning

²⁰⁹ E.g. A.O. Krueger who analyses the implications as far as the use of rules of origin is concerned.

²¹⁰ De Melo, Panagariya, and Rodrik, for example, consider the respective welfare effects of the different possible regional integration arrangements (De Melo, Panagariya, 1993).

²¹¹ This result is considered by Bliss to be a "typical economist's result" (and indeed the same could be said of the ones mentioned above): although it goes to the essential point of gains in efficiency, it assumes that policy makers have at their disposal ideal instruments, and that agents (here the rest of the world) react in a rational way (Bliss, Braga De Macedo, 1990: 20).

²¹² See Hine (1994), El-Agraa (1994), De Melo and Panagariya (1993), Gunter in Greenway, Hyclak, and Thornton (1989)...

endogenous growth.²¹³ Empirically, it is the Emerson report on the effect of the implementation of the single European Act which marks an important contribution in Applied Economics (Emerson et al. 1988); it was followed by a series of studies which qualified the optimistic view of the Emerson report, but which dealt with the matter in the same spirit²¹⁴.

Regional integration vs multilateral liberalisation

A distinct approach to regional integration is rather concerned with its *external* consequences. The debate over the potential clashing objectives of regional arrangements and world-wide trade liberalisation has been recently revived by the development of regional schemes of co-operation like the NAFTA, along with the apparent faltering commitment of the traditional US commitment to multilateralism [De Melo, Panagaryia, 1993]. Very roughly, there is on one side the tenants of multilateralism who stress the contradictions between the two liberalisation modalities, and argue that regional arrangements, if not carefully channelled, can imperil the wider objective of free trade²¹⁵; and on the other side, there are those who maintain that regional liberalisation is a first step in the establishment of free trade at the world-wide scale²¹⁶. This second approach is approximately the position expressed by the GATT in its Article XXIV, where Custom Unions and Free Trade Areas, if based on the principle of total preference, are considered to be 2nd-best paving the way for generalised free trade.

Locational issues

It is worth noting that the questions at stake in the studies on regional integration mentioned so far are mainly concerned with *efficiency* issues: the benchmark adopted to assess the effects of regional trade liberalisation -sometimes only implicitly- is an hypothetical state of optimal allocation traditionally associated with free trade. In this view, it is assumed that the outcome of unrestricted trade liberalisation is known, and that it brings about optimal results; the question is thus the extent to which the regional setting for such a process alters the 'normal' issue. This is clearly the case for the problematique 'regionalism' vs 'multilateralism', as well as for the determination of the welfare effects of regional integration. As to other approaches (e.g. that concerning the dynamics of regional integration), if they do not deal directly with efficiency matters, they neither address the question of the influence of regional integration on the distribution of economic activity within an integrated area.

²¹³ See, for example, Ethier, and Horn (1984) and Smith and Venables (1990), quoted in Hine (1994).

²¹⁴ See Winters, and Venables (1991), and Winters (1992).

²¹⁵ See for example Bhagwati (1992a), and 1992b).

²¹⁶ See for example, Krugman (1992), and (1993).

Yet, *allocation* issues are no less important. Although the consequences of regional liberalisation and integration on the allocation of resources seems intuitively far-reaching, there are surprisingly few studies addressing the matter. Brown and Stern, for example, identify 3 channels whereby integration schemes affect member countries: intersectoral specialisation, rationalisation effects, and macroeconomic consequences²¹⁷

A first strand of researches dealing with the former category seeks to determine the type of trade specialisation regional integration brings about. As a matter of fact, the hypothesis that intra-regional trade is more likely to be of an intra-industry sort has been proposed, mainly on the basis of the empirical evidence provided by the European experience (see Chapter 4). But this attempt does not really tackle the *where*-question.

A second type of researches is ascribable to the field of Economic geography which provides, a priori, an ideal background for tackling the impact of trade liberalisation on the location of industries: markets are considered to be 'spatial' entities²¹⁸, and notions like 'agglomeration' brought into the picture. A first version of this strand dates back to Alfred Weber's work on location theory formulated in 1929²¹⁹; subsequent analyses adopting a 'spatial' view of economic activity comprise, among others, Perroux's discussion of poles of development, and Giersch's idea that economic integration weakens agglomeration along national lines²²⁰. Balassa himself introduces locational considerations in his theory of regional integration with the distinction between mobile and immobile external economies.²²¹

But there are some attempts, at the margin between International Economics and Economic Geography, addressing locational issues in the context of regional trade liberalisation. Krugman and Venables, for example, look at the integration of peripheral low wage countries into a core of larger and more developed countries [Krugman, Venables, 1990]. They propose a model for determining the effect of such a process on the competitiveness of the periphery's industry where the outcome varies according to the degree of trade liberalisation. When trade barriers are high, industries can be marginally relocated in the periphery, with the only objective of accessing local markets; when trade is being liberalised with still significant barriers, industry is likely to remain in the core countries in order to take advantage of higher economies of scale; it is only when trade is completely liberalised that industries are relocated in the periphery to take advantage of lower wages. This example is quite unusual in relating the form of trade liberalisation to changes in the location of economic activity within an integrating area²²²: even

²¹⁷ Brown and Stern (1989) quoted in Hine (1994).

²¹⁸ This characteristics of markets flows from the observation that there are transportation costs, and more generally that intermarket transactions entail peculiar costs.

²¹⁹ Cf Alfred Weber, *Theory of Location of Industries*, 1929, Chicago: Chicago University Press. Quoted in Balassa (1961: 193).

²²⁰ Op. cit; 192.

²²¹ Whereas the former are not bound to a certain location, the latter are localised. See Balassa (1961: 195).

²²² ... as much as its practical relevance is limited.

when the location effects of trade liberalisation is tackled, only scant attention is paid to the *forms* of trade liberalisation. Trade liberalisation is taken for granted, and barely any distinction is made between the process and its result: trade liberalisation is usually identified with its outcome, i.e., free trade.²²³

Regional integration and regional development

Alternative approaches to regional integration rather place the stress on the economic dimension of integration without much reference to the institutional form of the regional setting within which the latter takes place.²²⁴ This is particularly the case of approaches developed on the basis of the empirical observation of the Asian regional model of integration; the latter being indeed characterised by the absence of political agreement.²²⁵ Conceptual tools have been put forward such as the 'flying geese' analogy according to which a regional dynamics of integration is established on the basis of the spread of development models from country to country.²²⁶ Applying Vernon's Product Cycle Model to the Asian regional context, international trade followed by the relocation of production activities in successive waves, is considered to be the channel through which a process upgrading country's comparative advantages and local technological capability takes place.

An interesting counter-argument can be developed on the basis of the notion of Cross-National Production Networks. In Ernst's definition, they correspond to

"the organization across national borders of research and development activities, procurement, distribution, product definition and design, manufacturing, and support service" [Doherty, 1995].

Their development is to be connected to the transformation of the conditions of international competition and to the trends towards the out-sourcing ('hollowing-out') of firms' activities.

Bernard and Ravenhill, for example, use the notion of production networks to account for the process of regional integration in Asia. The driving force of such a process are: the globalisation of production networks, increased intergovernmental dispute over bilateral economic relationships, and the rapid pace of technological change [Bernard, Ravenhill, 1995].

²²³ Thus in modelling trade liberalisation, it is often referred to the complete elimination of tariff. At best some proxies for Non Tariff Barriers are the basis for computation.

²²⁴ See also the opposition between 'corporate integration' and 'regional integration'.

²²⁵ However, mention should of course be made of the ASEAN programme of trade liberalisation. ...

²²⁶ The 'flying geese' analogy was developed, among others, by Bruce Cumings in 1984.

They argue that rather than the migration of products across national economies, the Asian development pattern produces

'a new regional division of labour that is based not on national economies but on regionalized networks of production' [Bernard, Ravenhill, 1995: 206].

2. OPT and the political dimension of economic interdependence

One major assumption characterising most of the above theories of regional integration is that although they study the interaction between economic interdependence and the legal framework providing for it, the two domains of politics and economics are held separate in the sense that they are considered to be ascribable to distinct logics. The OPT example, on the contrary, questions the separability of 'pure' economic determinants (market forces) and political and institutional factors. There are several facets to this features with different implications.

Trade liberalisation matters

First, the OPT example invites to remedy the lack of consideration given to locational issues. More precisely, it pinpoints the politicisation of the effective distribution of economic activity.

One illustration of the political dimension of the EU-CEEC pattern of economic interdependence is indeed given by the fact that institutional factors like the form and the speed of trade liberalisation influence trade specialisation and the division of labour at the regional scale. Indeed, the actual process of trade liberalisation to which the OPT arrangement contributes is a fully-fledged component of the framework of constraints and opportunities in which firms take their decision. It was argued earlier that the OPT legislation not only makes possible relocation in sectors heavily protected, but it also biases the overall economic exchanges between the EU and CEECs. It does so in at least two ways. First, features like the partial or complete suspension of trade restrictions, access to high quality inputs for free and possible technology transfers and know how spillovers, represent for local partners truly appealing incentives. This is a bias toward OPT at the expense of other possible vehicles of international production [Corado, 1995].

Second, by liberalising trade in an uneven and protracted way, the OPT arrangement is a very effective tool for discriminating between products, firms, and sectors. Drawing its *raison d'être* from the residual existence of trade obstacles *during* the liberalisation process, the OPT example makes clear that trade liberalisation does not take place all at once, suddenly freeing

market forces. On the contrary, the above analysis of trade restrictions measures pertaining to OPT (Chapter 2) showed that the bindingness of the latter is quite significant. Thus, the transition period during which trade is being liberalised matters; far from being neutral, it has an important impact on trade specialisation.²²⁷

Seen in this light, the OPT arrangement is indeed an ingenious device favouring Western producers in the exploitation of CEECs' comparative advantages at the expense of local firms. It creates the basis for compatible patterns of trade specialisation and industrial organisation in sectors which are typically a potential source of threat, i.e., where local actors would have the best chances to develop their own competitive positions in the so-called "sensitive" sectors. In other terms, it transforms 'rivalry' into 'complementary' patterns of specialisation [Zysman, 1996].

Firm-specific features matter: the size of OPT partners

Interestingly enough, the above institutional factors, i.e., the form and the speed of trade liberalisation in general, and the OPT arrangement in particular, can have far-reaching impacts on the patterns and the terms of economic interdependence between the EU and CEECs. But not necessarily the ones expected. Indeed, the empirical part suggests that OPT incidence can go far beyond such a 'shallow' level and digs deeper into the terms under which the regional division of labour is shaped.

In fact, it is not simply institutional factors which alter market forces: firm-level variables play also an important role. As argued in Chapter 4, institutional and market determinants take their full significance through the 'prism' of firm-specific variables. It was seen that depending on the size of the firms party to an OPT agreement, the OPT arrangement yields very different contributions to the patterns of regional integration.

Firms' size acts as intervening variables by making sense of the bindingness of trade restrictions. Big firms with important production capacities, in sectors facing binding quotas, are likely to resort to OPT for a large proportion of their production in order to ease quantitative restrictions, and access EU markets. In this case, OPT can provide a useful substitute for internalisation, thus favouring the 'vertical quasi-integration' of firms party to an OPT agreement. Big firms are, therefore, more likely candidates for the consolidation of OPT partnerships than smaller counterparts.

²²⁷ Time considerations, when at all, are tackled in the context of the debate regionalism vs multilateralism. See, for example, Hine (1994: 247), and Baghwati in De Melo and Panagariya (1993).

3. The contribution of OPT to the dynamics of regional integration

Different OPT networks, and different trajectories

Very differentiated outcomes result from the fact that firm-level variables intervene in the structuration of OPT relationships. It was shown that the notion of 'OPT Networks' is an intermediate unit of analysis particularly germane to capture the multiple variations of the features characterising OPT partnerships. They consist of a 'trinity' comprising the home country, the host country, and the sector.

Looking at OPT networks made possible the identification of very uneven and unsystematic patterns of OPT relations between the EU and CEECs.

For a start, the criteria of the home countries of OPT firms made clear that OPT is a very German story. To a much lower extent, Italian firms were able to take advantage of the arrangement in a significant way. It is also a strategy adopted by Dutch, Italian and French companies, but at a much smaller scale, and mostly (if not only) in T&C.

A fundamental sectoral difference is given by the divide between the textile and clothing industry on the one hand, and sectors like electrical and mechanical machinery, on the other hand. Whereas T&C OPT absolute levels and proportions in total trade are increasing at exponential rates, the latter sectors have been registering reductions of OPT dependence²²⁸.

As to consideration pertaining to host-country variables, they make clear a striking distinction between the former Czechoslovakia which is increasingly attractive to German OPT partners and Hungary which markedly reduces its dependence on OPT with German firms.

Further distinction is to be made by combining the above features. German OPT networks in the former Czechoslovakia are widely extended across sectors, and tend to be characterised by long-term horizons. In Hungary, instead, they are in a withdrawing phase. On the face of it, OPT networks involving new-comer Italian partners in Hungary are comparatively more dynamic, more footloose, and specialised in relatively original sectors like pharmaceuticals and plastics. As to OPT networks in T&C, they involve firms from more diversified home countries, and are characterised by extremely high proportion of OPT in total trade.

The use of OPT and its underlying logic is likely to vary widely depending on the OPT network considered. The latter are likely to differ in several ways, for example with respect to their geographical structure. While some partnerships source increasingly locally (and/or from

²²⁸ Further distinguishing between the two latter sectors, strong decreases of OPT absolute levels characterise the mechanical sector, whereas the exact opposite tendency is specific to the electrical machinery sector ...

other CEECs), other make exclusive use of exported inputs. Similarly, as far as the output is concerned, certain OPT networks are characterised by a peculiar tendency to gear the processed products to a third EU country rather than to the original home country. OPT networks differ also according to functional and organisational considerations: whereas some of them are closely associated with the reorganisation of the sourcing system of big multinational companies at the regional level, others are motivated mainly by costs differentials and are designed in a traditional bilateral way. Yet another distinctive trait has to do with the nature of the tasks relocated with local partners, going from the entire value-added chain to only some specific and usually very labour-intensive stages of production.

Most importantly, the fact that the institutional determinants of OPT make sense at the level of the firm entails a wide range of differentiated outcomes as far as the prospects of OPT partnerships are concerned. There are thus many possible 'trajectories' characterising each single OPT network, and the size of OPT partners was shown to be a useful discriminant.

They revolve around a pivotal alternative. In the case of big firms, OPT agreements are more likely to shift away from "one-way" relationships, turn into more equal and balanced partnerships, and move up along the value added chain. On the contrary, OPT relations involving smaller partners, are more likely to be sensitive to rising wage levels while distance (proximity) cannot remain the only incentive.

The empirical evidence of Part II speak in favour of the formation of Cross-National Production Networks (CNPN) in the T&C . Some possibilities were also found mainly between Czech and German partners, and mainly in the electrical machinery sector.

In these cases, the contribution of OPT to a complex rationalisation of production activities at the regional scale is mostly ascribable to individual corporate strategies adopted by big firms. The latter adopt a true regional outlook where wages levels, even though they were initially primary factors, fade away in comparison with other motives. In the T&C sector, for example, relocating to CEECs makes it possible to implement new production techniques which, in turns, satisfy to the requirements of a more complex and volatile demand. Thus CAM techniques²²⁹ enable Just in Time and lean production methods. By shortening the cycle of production, OPT thus becomes a powerful instrument to respond very quickly - say 3 days - to sudden changes of fashion and demand.

Big firms in the T&C sector like Hugo Boss (recently bought by Marzotto) and Baumler have taken advantage of the arrangement in this view. They are therefore successful examples of strategies keeping up with the latest technological developments.²³⁰

²²⁹ Computer Assisted Methods

²³⁰ They offer a picture which contrasts with that brushed by Mytelka in her description of the latest sluggish developments in the Korean T&C. See Mytelka 1995.

In the other cases, on the contrary, it was proposed that OPT most likely corresponds to cross-border transactions undertaken by German SME in neighbouring countries in order to ease high labour costs at home. Proximity can to a certain extent off-set rising wages, but this type of OPT is anyhow likely to be driven by shorter term considerations in the context of a strategy designed in a very bilateral view.

Different impacts on regional development

If firm-specific features like the respective size of OPT partners are an important intervening variable in the determination of OPT trajectories, it means that the terms of the complementarity achieved through OPT take actually their full significance at the level of the firm. This has far-reaching implications for the terms and the dynamics of regional economic integration and it makes any generalisation impossible.

In the case of the cessation of an OPT partnership, whether foreign partners re-relocate their activities further East while transforming their local OPT partnership into long-term engagement, or whether they simply withdraw from their commitment without contemplating alternative strategy obviously entails different consequences in terms of local and regional development. Hence, the trajectories of OPT networks can either contribute to make rival specialisation patterns complementary through a durable vertical division of labour (vs homogeneity and horizontal linkages), or merely revert to rivalry. In the former case, rivalry can be made complementary either in space (with the possible emergence of Cross National Production Networks) or in time (with successive waves of relocation in conformity with the predictions of the Product Cycle Model, and the flying geese analogy).

In the former case, OPT contributes to the definition of a hierarchical division of labour based on regional heterogeneity. On the contrary, when OPT is driven by the search for lower factor prices, much will depend on whether local firms can take over OPT production on their own, and thus pave the way for indigenous autonomous development. Yet another issue at stake concerning the case of prolonged OPT partnerships, is the question as to whether local partners are durably locked into a low wage specialisation pattern.

The available evidence speaks broadly of a complementarity achieved in space in the T&C sector, while cross-border transactions of the 'maquilladora' type take place in the other sectors, mainly between German and Czech partners. Interestingly enough, the respective trends characterising German OPT in Hungary and in the former Czechoslovakia suggest that rather than 're-relocation' further East to countries where wage conditions are still favourable, it is an 'inbound' wave of relocation which has occurred, taking advantage of proximity.

CNPN in T&C convey the most favourable prospects for the development of local capabilities, and eventual movements up the market. As a matter of fact, they are in principle an adequate vehicle for organising technology transfer. In the other cases where OPT developments mainly correspond to 'workbench' activities undertaken by German firms in their Eastern neighbour countries, the issue in this respect is more uncertain. However, evidence from trade statistics and from fieldwork suggested that Hungarian firms were successful at disentangling from OPT and at taking over production on their own. If this is anything to go by, even when it corresponds to the workbench activities of smaller firms designed on a shorter time-horizon, OPT has some potentials for strengthening local capabilities.

Overall, the OPT contribution to the establishment of a regional dynamics of integration varies according to the sector concerned, the size of the partner firms, and the partner countries, i.e., that it differs depending on the considered 'OPT network'.

An interesting policy implication is that if CNPN which are the direct product of Western policy choices, are also the most beneficial in terms of local development, an invitation is indirectly extended to local governments to adopt a more active stance: the development of local technological capabilities through OPT is also a policy matter.

Answers to theoretical contributions on Regional Integration

The above picture of the contribution of OPT to economic interdependence between Eastern and Western Europe provide many direct answers to some distinctions and predictions too fast taken for granted in the literature on regional integration.

The fact that the location and distribution of economic activity can be, to a large extent, institutionally and therefore politically underpinned has important consequences as far as the basic distinction between 'liberalist' and 'dirigist' approaches to regional integration is concerned. It questions the pertinence of the position held by the proponents of regional integration limited to free trade as opposed to more interventionist developments. In other terms, the validity of the distinction between *positive* and *negative* integration is at stake. The empirical evidence showing how OPT affects CEECs' trade specialisation and the division of labour between the CEECs and the EU thereby anchors the view expressed by Balassa into concrete demonstration; in his words, it would be a

"great error to believe that the decision to create regional unions would re-establish the conditions of an economic liberalism extirpating with one stroke all the so-called dirigist policies" [Balassa, 1961: 9].

An additional channel through which the institutions implementing regional integration alter economic outcome is therefore identified.²¹ The OPT story invites to focus on the locational consequences of trade liberalisation within a regional context. It shows that institutional factors like the form and the speed of trade liberalisation are an important source of alteration of market determinants.

In a straightforward way the OPT example also invites to reconsider the distinction between shallow integration (limited to trade) and deep integration (encompassing production activities as well). As a matter of fact, the institutional background shaping the trade specialisation resulting from trade liberalisation resorts primarily to trade policy instruments, but its ultimate impact is to be gauged on the organisation of international production activities throughout Europe. In this sense, the OPT mechanisms can be viewed as 'Investment-related trade measures'; they illustrate how integration through trade and integration through international production activities can occur simultaneously, the 2 being different dimensions of the same phenomenon.

More generally, one of the most interesting implication of the OPT insight for theories on regional integration, has to do with the very differentiated patterns of economic interdependence the arrangement can yield. In this respect, adopting narrow units of analysis like OPT networks is the only way to capture the many possible variations characterising the development of OPT between Western and Eastern Europe and its contribution to the process of regional integration. This precludes sweeping generalisations on the terms of East-West economic interdependence. For example, concerning the prospects of the expansion of the current process of regional integration in Europe, generalisations accounting for the political economy of the formation of free trade areas like those put forward by Baldwin in his 'domino' theory no longer hold [Baldwin, 1995].

²¹ Four are already defined by De Melo et al (1993). They are: the functions of 'purchase-commitment', 'preference-dilution', 'preference asymmetry', and of 'institutional-design' of regional integration.

5.3 Conclusion

The present Chapter explored the way in which an integrated Europe is a response of national governments to the internationalisation of firms strategies. Before drawing too general conclusions, it is worth addressing the issue of the exemplarity of OPT. Indeed, the mechanisms characterising the OPT story are not necessarily at work in other domains of European integration. One would therefore be ill-advised to conclude *in general* on the inappropriateness of harmonisation as an integrative mode or on the relevance of the notion of production networks to characterise East-West economic interdependence.

This is actually more than a caveat. Paradoxically, the limited pertinence of OPT is a feature which has itself a general validity. It invites to consider the whole process of integration as compounded by a set of differentiated arrangements, which are not necessarily working in the same direction, and which therefore do not necessarily produce a precise, pre-definite outcome. It suggests that the Community is not a polity in formation supposedly undergoing a period of transition before reaching a final but unforeseen destination²³². Rather than a dynamic continuum between an intergovernmentalist starting point and a federalist outcome, Keohane and Hoffmann convincingly propose to view European integration as a 'supranational process' which is not directionless, but which is not to follow predetermined and/or normative patterns of development: it is neither an emerging state nor a regime [Keohane, Hoffmann, 191: 10].

What is more, the contribution of the arrangement to European integration itself is far from univocal. Whether OPT promotes the deepening of the process and under what (economic) terms it participates to the Community enlargement depends on the sectors and the partner countries concerned.

In the following, it is necessary to combine the points made in the present Chapter. On the one hand, the OPT arrangement did not achieve the centralisation of competence on OPT matters at the Community level; on the other hand, its contribution to the terms of economic interdependence within an enlarged Europe is highly uneven.

²³² It is an approach mainly characterising the federalist standpoint.

Chapter 6. Conclusions: globalisation and governance

The present Chapter draws the conclusions from the above analysis of the contribution of OPT to the European integration process, in both its widening and deepening aspects. Its objective is to provide an overarching framework of analysis combining the various insights that the study of OPT suggests.

As a matter of fact it pulls together different tales which are only apparently disconnected. On the one hand, it was shown that the arrangement has been adopted and has developed in the context of what is commonly considered to be the progressive loss of political control over economic interdependence in certain sectors. However, contrary to what might have been expected, this did not favour an effective centralisation of competence at the European level. As a result, a nascent Community-wide industrial policy could not take root, and distinct national regimes kept on providing different frameworks of constraints and opportunities.

On the other hand, the central part of the dissertation insisted on the importance of the notion of production networks to account for the patterns of economic interdependence developing within the context of the eastern enlargement of the EU. It was made clear that the contribution of OPT to the dynamics of regional integration varies widely from OPT network to OPT network. It is only in certain sectors and between certain partner countries that the mechanisms of OPT do effectively promote a complex and durable division of labour at the regional scale.

This concluding Chapter draws the full implications from these evidences for the Governance of the economy. It might be tempting to interpret the above developments as an illustration of the failure to implement a system of governance of the wider European market economy. In fact, they illustrate the failure of *transposing the national model of governance at the Community level*. At the same time, they pinpoint alternative and sui-generis mechanisms of governance underlying the European integration process.

The fact that the strong potentials of the OPT arrangement to establish a system of governance at the European level moulded on the national model were not seized suggests the inadequacy of the latter to cope with economic interdependence. Such a model presents indeed several shortcomings like the reference to the notions of territory and boundaries, and beyond, the very way in which political authority in economic matters is exercised.

The mechanisms of governance highlighted by the OPT developments, instead, do not necessarily refer to a territory comprised within boundaries and they do not necessarily involve the traditional actors considered to be the exclusive source of politicisation of economic activity. The risk is that by being radically new, these mechanisms of governance are not acknowledged

as such. But they deserve as much if not more attention than the traditional system, if anything because they are perhaps more germane for tackling the fast-developing mutations at work in the world economy.

Overall, the OPT example suggests that it is perhaps too fast and easily referred to a territorial frame as a unit of analysis, and a centralised political authority as a major player in the game: as though the governance of the economy could not take place at other levels, and at the instigation of actors playing new roles.

6.1 The governance of the economy: on the indeterminacy of economic necessity

1. Premise

A system of governance of the economy can be defined as a mode of interaction between economic and political variables. First comes the economic imperative acting as an irreducible constraint. Then additional 'political' factors ('exogenous' as economists would put it) complete the picture: whereas economic variables have a primary crucial bindingness over the eventual outcome, the latter is fully determined only in co-ordination with political variables. In other words, because of the (omni)presence in economic action of logics other than that of the market, a 'purely economically-driven economic behaviour is undetermined' [Hollingsworth et al., 1994]. Overall, according to Hollingsworth, Schmitter and Streeck, a system of governance refers to

'institutional arrangements -including rules and rule-making agents- that regulate the transactions inside and across the boundaries of an economic system' [Hollingsworth et al. 1994: 4].

This premise is indeed the basis of studies in Political Economy.²³ In *Rival States, Rival Firms*, Stopford and Strange show how common constraints in the international political economy can trigger very different policy response. Other classic examples like Hall's and Gourevitch's comparative analyses of economic policy, posit as a starting point the indeterminacy of economic factors. Whereas Gourevitch refers to the 'politics of policy'

²³ The research agenda in (International) Political Economy places the emphasis on the *synthesis* between Economics and Politics rather than merely looking at their relations. See Strange (1994: 14).

[Gourevitch, 1986: 2], Hall considers economic policy-making to be a highly political process [Hall, 1986].

The above definition is usually associated with some underlying assumptions which tend to be perhaps too fastly taken for granted. First, it is commonly implicitly considered that a feature characterising a system of governance of the economy is the *congruence* between the domain of application of political variables, and that referred to in economic calculations. Second, although such a field of congruence can, in principle, have different dimensions, the most commonly adopted is the national constituency. Third, because of such a focus on the national frame, state authorities are often considered to be the main, if not the exclusive source of structuration.

2. Shortcomings

The above underlying assumptions regarding the working of a system of governance are at best questionable. Some theoretical developments are useful to see why before embarking on the analysis of OPT contribution in this respect.

Theoretical perspective

Several theoretical backgrounds studying economic activity under different perspectives are useful to highlight different levels and mechanisms of structuration of economic activity.

Different units of analysis

The above definition of a governance system invites to further concentrate on the question of the unit of analysis. Starting with as comprehensive²³⁴ as possible a list of the possible spatial and organisational boundaries of systems of structuration of economic activity is indeed a good way to relativise the unicity of the nation-state level and its associated mechanisms of governance. In turns, this will make easier the identification of alternative systems of political governance of the economy, which are traditionally neglected if not ignored for the simple reason that they do not take place within national frontiers.

Paying attention to the question of the appropriate unit of analysis is a good opportunity for putting forward the lowest one which is often neglected: firms. Indeed, before asking whether patterns are to be detected at some higher level of aggregation, the analysis should be grounded

²³⁴ but never exhaustive ...

on a close monitoring of corporate strategies. For example, when studying 'industrial restructuring', Ruigrok and van Tulder pertinently refer to

"changes in the way goods and services are being developed, designed, produced and distributed, i.e., to changes in *companies'* organisation structures and the technology they use" [Ruigrok, van Tulder, 1995: 2].²³⁵

Indeed, different typologies of possible restructuring strategies should primarily apply at firm level. For example, firms may opt for horizontal specialisation (inter-industry switch, specialisation and product innovation, up-market and niche strategies), locational specialisation (off-shore processing, 'finishing touch' assembly, manufacturers' imports and distribution activities, and foreign direct investment), and defensive/rationalisation adjustment (modifying the factor content of production and transforming a labour-intensive production process into a capitalistic one) [Cable, 1983]. An alternative categorisation is proposed in the Commission report on the competitiveness of the European T&C industry and may very apply to the firm level as well. There are four options: modernisation of product plants, relocation to low-wage countries, specialisation and product strategy, and change of organisation and methods [CEC, 1993: 35].

Next in the hierarchy of the possible levels of aggregation of economic activity are 'sectors'. The notion is quite controversial ... and should definitely not be directly taken over from trade and industrial nomenclatures.

Sector-level analyses tend to be neglected by the International Business and International Production literature. An important exception, however, is given by *Rival States Rival Firms* which show how changes in the conditions of international competition has had uneven impact on industries [Stopford, Strange, 1991]. In general, sectors or industries are adopted as a pertinent level of analysis in some studies in Comparative Politics.

One question is whether sectors are referred to in opposition to or in combination with the national level of aggregation. Are we talking about national sectors, or is it a "mere" sectoral logic across countries which is at stake? This makes a difference as the latter notion is purposely designed to address the phenomena of globalisation: whereas a sectoral logic across nation is determined by economic and technological factors, national sectors of activity are subject to politicisation by national determinants.²³⁶

A related question is whether the sector as a unit of analysis is not sometimes unduly exchanged with the firm level. As a matter of fact, it might be that certain firms are big enough

²³⁵ Italics added.

²³⁶ Interestingly enough, in this view, globalisation is associated with the prevalence of a universal economic rationality depoliticised and reduced to the bare bones of technological necessity.

to dominate an entire sector: in short, they *are* a sector. This is a danger presented by too literal an analysis of statistical figures ordered in nomenclatures. Indeed, the confidentiality principle hides the firms behind the headings. Again, whether the activity of just one or two big firms accounts for the bulk of a 'sector' activity is a feature which is very much in conformity with the 'critical size' necessary for facing the new modality of international competition.

These points of contention are those at stake in the notion of "sectors" as interpreted by Porter, and the proponents of related notions such as "cluster", "industrial complexes", and "global commodity chains" ... Porter's analysis of sectors' competitiveness, for example, stresses the importance of the national setting. In his view, political variables bear upon corporate behaviour through the influence that national authorities in charge of policy-making have on the 'environment' in which firms decide upon their strategy. To be precise, there are 4 of such variables: the so-called '4 diamonds' ... are all factors fostering the *competitive* advantage of firms. If any aggregation of firms' competitive advantage is to be carried out, it does not go beyond the level of the industry, which is deemed to be the appropriate unit for analysing competitiveness.²⁷ Even though the analysis, which is concerned with firm-level variables, rules out the notion of national comparative advantage, it nevertheless still applies to *national* sectors of activity.

Still placed in the context of the national setting, but referring to other mechanisms whereby national factors influence economic activity, the analysis of "clusters" is based on Freeman and Pavitt's studies of technological innovations. In a technician and structural vein, the authors address differences of technological capabilities and innovativeness between countries and gauge the effects of such differences on international patterns of trade and growth [Dosi et al., 1990]. In doing so, they come to the conclusion of the importance of sectoral differences between national patterns of specialisation. On this basis, some economists have developed the notion of clusters, better suited to trace structural changes in specialisation than the too 'merceologist' notion of sectors taken over from usual nomenclatures.²⁸ They show how technological capabilities, characterising a given national context, are crucial in determining productivity and competitiveness at the level of firms. This in turn impacts at the sectoral level, thus establishing a strong relation between sectoral and national variables:

²⁷ Hence the inadequacy of the notion of comparative advantage which applies to the national level. In a similar vein, Zysman evokes 'man-made comparative advantages' (in Krugman, 1991). It seems that there is only a semantic difference between Porter's strand of arguments and Zysman's analysis of Japan's industrial policy. Indeed, according to the latter, the Japanese authorities managed successfully to build "comparative advantages" by strengthening firms' "competitive advantages". Here 'comparative advantages' are meant to apply to sectors. See Zysman (1983).

²⁸ See for example Guerrieri (1994), who uses a trade database distinguishing between 4 types of industries according to their different techn(olog)ical requirements: science-based sectors, specialised supplier sectors, traditional sectors, natural resource-intensive sectors, and scale-intensive sectors.

“on the one hand (...) processes of technological changes tend to assume varying sectoral features (...), on the other hand, the competitive trade advantages of single countries are concentrated on given industries and clusters of industries” [Guerrieri, Tylecote, 1994: 50].

Even though Porter's and the cluster analyses consider eventual production organisation to take (partly) place along national lines, the way is paved to relativise the absolute prevalence of national traits in the mode of structuration of economic activity. In concepts like 'industrial complex', and global commodity chains, national political variables have a different status: if not marginal and loosely binding, they have become only one factor among others. Ruigrok and van Tulder, for example, identify 'industrial complexes' which link together core firms, supplying firms, dealers, distributors, workers, financiers, and governments [Ruigrok, van Tulder, 1995: 7]. Such industrial complexes can be contained within what they define a 'national industrial systems', but this is not necessarily so. One has therefore to distinguish between the two:

“if a national economy contains more than one industrial complex, therefore the distinction between the individual complex and the national industrial system becomes relevant” [ibid.: p117].

Another shift in the level of analysis inspired by the fast developing globalisation of economic activity is proposed by Gereffi and Korzeniewicz (1994) and their notion of 'global commodity chains' (GCC). The definition they put forward is very similar to that of industrial complexes:

“a GCC consists of sets of interorganizational networks clustered around one commodity or product, linking households, enterprises, and states to one another within the world economy” [Gereffi, Korzeniewicz, 1994: 2]²³⁹.

The difference is that reference to national determinants is to a higher extent relativised.²⁴⁰ The very *raison d'être* of global commodity chains is the exploitation of opportunities on a global scale²⁴¹: the three criteria used to distinguish between GCCs (the form

²³⁹ This definition takes over that proposed by Hopkins and Wallerstein for whom a GCC is a “network of labour and production processes whose end result in a finished commodity” (1986:159) quoted in ibid.: 2.

²⁴⁰ There are other differences with the notion of “industrial complexes” besides the question of the relevant unit for analysis: the analysis is less descriptive, and more concerned with dynamic (normative?) considerations such as the possibility for upgrading and changing the distribution of wealth along the chain.

²⁴¹ GCCs aim at two broad objectives: reducing either transaction costs or labour costs. The first case translates into vertical integration and geographical convergence, whereas the second case is associated with contractual forms of inter-enterprises co-operations like sub-contracting. These two cases, in turn, correspond to 2 different phases in the cycles that the world economy undergoes [Ibid.: 20].

of a GCC's input-output structure i.e., its value-added chain, its territoriality, i.e., its spatial configuration of production and its plants distribution, and finally, its governance structure, whether centralised or not (ibid.: 7)) can occasionally refer to the national context, but they do not necessarily and systematically do so.

Among the possible levels of aggregation of economic activity, the national setting still occupies a place of first choice. Fair enough it has long been and probably still is a prominent 'agent of structuration' of political, economic, and social activity.²⁴³ Determinants which bring about the 'nationalisation' of the outcome are successfully analysed by the literature on Comparative Politics; they can be grasped in a historical perspective, or by a more static analysis of national institutions.²⁴⁴

But the long-standing pre-eminence of national determinants in the structuration of economic activity is no reason for neglecting other levels of analysis, and other determinants arising from "without" i.e., pertaining to the conditions of competition in the world markets. Indeed, there is a clear risk of taking the national framework for granted as illustrated by the bias characterising the literature on Comparative Politics.²⁴⁴

It is worth insisting, at this point, that what is at stake is not so much the identification of the determinants than the scale on which they are considered to impact. It is all too common, even when factors on the international setting are acknowledged, to restrict the analysis to their consequence on variables defined in strict national terms. Most studies in Comparative Politics or in Political Economy make an unquestioned reference to the national setting, which is sometimes already at work in the very question addressed. Halls, for example, distinguishes between various competing models answering the question as to why nations adopt different economic policies²⁴⁵ The factors he identifies are all expected to impact nationally. Whether

²⁴³ For the elaboration of the concept of 'structuration' see A. Giddens

²⁴⁴ Wilks, for example, argues that being histories predominantly national so too are the institutions shaping the framework of constraints and opportunities within which economic decisions are taken (Wilks, 1996). Reference to national institutions being a major concrete factor that 'nationalise' economic behaviour is also at the basis of Gourevitch's analysis of policies adopted in response to economic crises. In a similar vein, Hollingsworth (1994) considers national institutions to be a possible prism through which economic necessity is expressed and dealt with.

²⁴⁵ Starting with the seminal work of Shonfield (1965) which pioneered research in comparative capitalism, a series of subsequent studies based their analysis of different economic systems on cross-countries comparisons. See for example, Albert (1994).

²⁴⁶ There are 5 of them: functionalist explanations, cultural analyses, public choice theory, group theories, and state-centric models.

identified on the domestic side,²⁴⁶ or in the international arena²⁴⁷, the determinants of the economic policy-making process 'nationalise' the outcome in terms of economic activity.²⁴⁸

That economic activity is not organised exclusively along national lines means that political factors do not (should not be expected to) necessarily bring about the nationalisation of economic outcome. Indeed the different levels at which economic necessity is politicised correspond fundamentally to different systems of governance of the economy.

Different mechanisms of governance

Parallel to the distinction between different possible units of analysis corresponds the differentiation between various mechanisms of governance. The latter might but need not necessarily correspond to the former. However, it worth starting by differentiating specific modes of governance of the economy²⁴⁹, with distinct mechanisms thereby politics impinges on economics.²⁵⁰ according to the level they possibly apply.

Even so, the endeavour is quite hazardous: if alternative levels of structuration of economic activity are acknowledged, it is quite paradoxically not necessarily so of mechanisms of political governance. Indeed, politicisation along national lines is often considered to be politicisation tout court. The answer would highlight that, even within the national frame, there are different systems of governance of the economy. This will prepare for the subsequent identification of alternative, and sometimes radically new systems of governance ...

Traditional instruments of economic policy, whether associated with a liberal stamp, or ascribable to a more active conception of state intervention in the economy form an often very

²⁴⁶ The respective organisations of labour, capital, and the state, the organisation of the political system through which business interests are voiced.

²⁴⁷ Constraints at work in the international economy, like the place of one considered country within the international division of labour.

²⁴⁸ The second major reference in the field, Gourevitch's analysis, suffers from the same drawback. His list of the 5 possible approaches to the choice between different packages of economic policy (classical liberalism, socialisation, protectionism, demand stimulus, and mercantilism) differs slightly in comparison to Hall's: cultural factors give way to determinants having to do with economic ideology and the too undetermined functional analyses are substituted with 'production profile' explanations maintaining that the preferences of societal actors depend on their place in the domestic and international economy. Eventually, he privileges explanations locating the main determinants of economic policy in the international system impacting on coalition-building (see his notion of 'second-image reversed').

²⁴⁹ Rather than the "governance of the economy", we should start talking about the "governance of international production" as "the economy" can easily be exchanged with "the national economy".

²⁵⁰ These different modes of governance are certainly not exhaustive. In order to give a better account of their complex nature, it is probably safer to consider them to be complementary rather than substitutable.

unquestioned system of governance of the economy (budgetary, and monetary policy, but also trade and industrial policy, re/de/regulation...). A slightly different approach to the national governance of the economy looks at the determinants of such economic policy; in other terms, the way interests are co-ordinated and represented, and their influence on policy-making. This version of a governance system rests on the assumption that interest groups mediate between state and society. There are two contending approaches: pluralism and corporatism²⁵¹. Both strands of studies are concerned with the question as to how 'collective action'²⁵² takes place; they consider institutional factors (like the political system) and, to a lesser extent socio-economic conditions and market factors, to be the main variables accounting for the form and the effectiveness of political expression. Group formation depends on

"the impact of national experience, the weight of intraorganizational factors in defining interests, and the role of the state in structuring relations among interests" [Berger, 1980: 10].

Whereas in a pluralist model, interest groups are held to compete in a political market none of them could dominate, in a corporatist scheme, labour unions and organised capital are two formations characterised by a major clout. That the national jurisdiction is the pertinent level for analysing (neo)corporatism goes without saying. Indeed, tripartite negotiations between labour, industry federations and the government take place under the auspices of the latter, which provides the ultimate warrant to the system. But it is also the case of the (neo-)pluralist approach. Even though pluralism allows for case-by-case bargains between economic actors (e.g. firms) and the political authority thus in principle making possible an analysis partially disconnected from national references (see Grant 1987), in practice, the analysis is systematically carried out within distinct national contexts.²⁵³ Thus whether in a pluralist vein, or according to a corporatist version, the study of business representation is irredeemably inclined to ask all over the same question of

"why different interests are present and organised in various societies and of why *from country to country* the same groups may conceive their interests quite differently" [Berger, 1981: 6].²⁵⁴

²⁵¹ This dual opposition is over-simplified. Mention should be made of approaches considering business as a "privileged interest" (see W. Grant, 1987), as well as those taking over the notion of 'policy networks' (see Marin, and Mayntz, 1991).

²⁵² M. Olson in 1965.

²⁵³ One study of reference is the Research Project of Schmitter and Streeck which produced a large amount of sectoral analyses tracing neo-corporatist patterns of negotiations among 'social partners'. See Schmitter, Streeck (1981). One published of such studies is Grant et al. (1988). See also Martinelli (1991).

²⁵⁴ Emphasis added.

Yet another way to approach mechanisms of governance referring to the national setting consists this time in looking more downstream at the influence of political authorities on the environment within which economic decisions are taken. As such, it is a milder way for national traits to characterise the outcome. This type of mechanism is the one (implicitly) at work in the analysis of clusters and sectors à-la-Porter.

More focused on individual firms, and more disconnected from the national context, the 'triangular diplomacy' depicted by Stopford and Strange refers to another mode of governance of the economy [Stopford, Strange, 1991]. It is based on a direct bargaining process between states and big multinational companies which are partners very much placed on an equal footing.²³⁵ It implies ad-hoc relations between partners in a negotiation, with outcomes varying from deal to deal and no pre-established whatsoever patterns. Here, an important shift has taken place: it is no longer referred to the national setting, or *territory* within which economic activity follows specific patterns. Rather, the emphasis is placed on governments; if anything *national* governments. What is important is that the proper unit for analysing the outcome is politicised not along national lines, but varies according to the negotiation, i.e., on a firm basis. It should be stressed that this view is not to be exchanged with the pluralist version of interest representation. Indeed the difference is the very scale on which the two mechanisms of interaction between economic and political (f)actors take place. In contrast with the triangular diplomacy model, states structures are, in the pluralist view, an overarching framework in which varying interests are opposed and harmonised. Similarly, the bargaining model should be held distinct from previous analyses of 'national champions' promoted by the state [Vernon, 1974]. Here again, the difference is in the relative position of states and firms: national champions, as powerful as they might be, are nevertheless under the sway of the state.

Bargaining relations are also at work between the different elements forming industrial complexes and global commodity chains (whether within or without the value chain).²³⁶ In this view, the transnational reorganisation of production activities in response to international competition is very much disconnected from the grip of national determination. In the analysis of clusters (to a lesser extent, industrial complexes) the influence of state's action is acknowledged,

²³⁵ Because of such an equal footing, the word 'governance' might be an usurpation: the question is indeed pertinent as to who governs whom.

²³⁶ Interestingly enough, such bargaining relations are associated with rival 'concepts of control' to which such industrial complexes adhere. The notion is borrowed from the Amsterdam school, but is applied to the organisation of production. Concepts of control are organised around three main types: the first concerns SMEs developing a competitive edge in flexible specialisation, the second is specific to big firms undertaking mass-production in a very Fordist line, and the third characterises vertically de-integrated firms relying on economies of scope ('Toyotism'). Later in the book, 2 additional concepts of control are added to the list: the fordist model is split into 2 distinct patterns: in the macro-fordist model, firms adopt multidomestic strategies in a regional context, whereas the micro-fordist model is based on comparative advantages, and is more cost-driven. Finally multidomestic are distinguished as well.

but apart from the fact that it is only one factor among several others, it does not bring about the nationalisation of the outcome: the level of structuration of the economy is less than ever the national setting.

Practical relevance

The above theoretical contributions invite to question the assumptions at work in the common definition of the governance of the economy along -at least- three lines.

First, the emphasis could be placed on alternative *levels* where economic necessity is politicised. A constituency moulded on the national model even if enlarged is far from being the only possibility.

Also, more attention could be paid to the very *mechanisms* of governance. Proposing that politics can make sense of economic variables at different levels, and that there are varying mixes of political and economic factors, is tantamount to acknowledge numerous and contrasting mechanisms of governance depending, among other things, on the level at which they apply. The all too common assumption of the unicity of the possible mechanisms of governance would have thus to be rejected.

Finally, the identification of the *source* of governance should be reconsidered. That the eventual outcome is not necessarily politicised along national lines questions the role of the state, and, beyond, of any centralised political instance modelled on its national counterpart as the unique possible source of structuration of the economic outcome.

Overall, it appears that the notion of congruence on which a traditional conception of governance rests is of limited pertinence; it can be quite misleading by bringing about too narrow a focus on spatial references. On the face of it, there is a multitude of political (f)actors making sense of economic variables; there are several ways for them to influence the outcome; and the outcome itself is structured at different levels. This requires more flexibility in the choice of the unit of analysis one is to adopt when studying economic policy-making and an open-minded attitude when considering the mechanisms whereby politics impinge on economics.

6.2 The OPT evidence

It is argued below that the OPT story is particularly illuminating in the light of the above developments on governance. It is a straightforward illustration of the politicisation of economic

activity (see Chapter 2). But because the actual politicisation is not necessarily the one expected, the OPT example illustrates -indirectly- the shortcomings of a traditional system of governance which appears antiquated in a changing world economy. 1

1. Rescuing a traditional system of governance

What happens in terms of governance if the geographical horizons of economic decisions extend well beyond the national boundaries? OPT illustrates the attempt to resort to one possible option. In a territorially-b(i)ased conception of governance, it is expected that such a mismatch calls for a geographical adjustment: the way to recapture political control over economic interdependence consists in redefining the spatial realm where centralised political actions apply in order to match newly with that of economic decisions. The ultimate objective is therefore to restore the congruence between the spatial reference made respectively in economic decisions and in the exercised of a centralised political authority.

Centralising competence

A crisis in the governance of the economy can be said to have taken place as the result of the dilemma between firms strategies relocating production activities abroad and the objective of protecting employment in declining sectors at home. Hence, the mismatch between the scale of firms' outlook, and the national frame within which economic policy is effective.

Several stages characterise the process. At first, an OPT policy in the textile and clothing industry was devised at the national level. OPT was a compromise solution making possible corporate strategies in conformity with the requirements of globalisation, while maintaining the process under tight political control. The national frame was still the uncontested reference.

But in the face of the constraint presented by the Community institutions and arrangements, OPT had to be 'europeanised', i.e., centralised at the Community level. It thus testified to the attempt of enforcing the governance of the economy at an alternative level. The mechanisms of governance themselves were not modified. What was on the agenda was their mere transposition.

Restoring congruence

In a traditional view, the centralisation of political competence in economic matters is accompanied by the necessary adjustment of the scale at which the competence of the newly

centralised authority applies to that referred to in economic calculations. This is to restore congruence between economics and politics as in the national model.

In this interpretation, therefore, the enlargement of the Community is a necessary corollary of its deepening process. And indeed the promised full political integration into the EU which is expected to take place following the eventual establishment of a free trade area between the EU and some of the Central and European countries can very well be analysed in this light. It is also in conformity with theories of economic integration (in particular the 'stage approach' described in Chapter 5) where political integration is expected to result from full economic integration.

Such mechanisms strikingly recalls those described by Braudel in his historical account of the emergence of national economies. One would simply refer to the regional instead of the national level:

"a national economy is a political space transformed by the state in response to necessities and innovations required by material life into a consistent and unified space which activities are geared to the same direction" [Braudel, 1985: 103].

Overall, OPT illustrates how the European Integration process in both its widening and deepening dimensions owes part of its *raison d'être* to the establishment of a system of Governance adopted in response to globalisation. On the one hand, devising an OPT policy at the Community level is expected to deepen the European integration process by shifting the source of governance of the economy from the national to the supranational level. On the other hand, the impact OPT has on the division of labour within an enlarged Europe contributes to the widening process of European integration. It enlarges the territorial constituency in which such a system of governance is expected to reward different social and economic interests. One would thus be tempted to conclude that the OPT policy adopted at the EU level is ascribable to the establishment of a 'regional economy' under the aegis of a centralised political authority.

2. Unintended consequences: the reasons of a failure

If this interpretation of the OPT story is correct, i.e., if it is ascribable to the tentative establishment of a traditional system of governance at the European level, then the findings of the dissertation summarised in Chapter 5 are nothing but the illustration of the failure of such an attempt.

First, it was made clear that the centralisation of competence in OPT matters at the Community level is only partially achieved. The harmonisation of national regimes was unevenly successful in the economic OPT regime. Even in the tariff regime, where an harmonised position was already achieved at the Community level, no centralisation of competence effectively occur.

Also, it was shown that the ultimate features characterising OPT relations between the EU and CEECs and their impact on the terms of East-West economic interdependence are largely beyond the control of Brussels's policy-makers. Indeed, if what is at stake in the OPT policy is to keep under (political) control the regional division of labour, then the objective is only partially satisfied for there is an irreducible indeterminacy concerning the effect of trade liberalisation. As matter of fact, the contribution of OPT to the regional dynamics of integration varies depending on the 'OPT network' considered, and its trajectory. The latter is itself largely shaped by firm-specific variables. Thus, institutional factors are only one series altering the determinism of market forces; firm-level variables also intervene and filter the ultimate outcome which varies widely from production network to production network.

Overall, the process consisting in rolling back boundaries in the hope that the enlarged constituency thus created would give rise to a system of governance newly congruent with the scale of economic activity is partially ineffective: recovering political control over economic interdependence is not to be expected from a mere shift in the scale of application of political activity. A regional economy à-la-Braudel is not to come into being.

The question arises as to the reasons accounting for such a 'failure'. Do they have to do with the mode of transferring competence (harmonisation), with the principle of the transfer (a mere 'transposition' of similar mechanisms without adaptation), with the very nature of the mechanisms transferred, and/or with the scale at which such mechanisms are transferred?

A definitive and clear-cut answer to such questions is difficult as the issues are closely intermingling. The reason put forward is therefore likely to be 'a bit for all these reasons at the same time'.

First, there is no reason to believe that patterns of governance moulded on the national model can be automatically transferred without loosing their integrity. Mechanisms at work on the national constituency might not be so easily manageable over a significantly wider area, and indeed the conciliation of the numerous and scattered diverging vested interests in presence in the OPT debate proved to be particularly difficult. On the face of it, one could argue that the possible ways of governing the economy are closely associated with specific scales of application on which their very effectiveness depends.

But besides the principle of transposing mechanisms of governance without substantial alteration, the adopted scale itself might not be the most germane to answer the challenge of international competition and of the globalisation of production activity. As a matter of fact,

“the jurisdiction of the European Community extends only to part of the world economy”
[Hollingsworth et al, 1994: ?]...

... but also that of an hypothetical enlarged Community with 20, 24 or whatever number of members. However enlarged, the European constituency is not a transposition of the national frame at a higher level and the mechanisms of governance expected to apply at the Community level are not those designed at the national one.

6.3 New stories in a changing world economy

The findings that national prerogatives and firm-level variables are two essential determinants of the expected complementarity between Eastern and Western specialisation patterns is of tremendous relevance. It makes possible the understanding of the actual way in which (and the level at which) the effective politicisation of economic activity occurs. The full implication of this is to be developed in the present section.

1. Alternative levels of the structuration of the economy: Blurring boundaries

Whether at the national or at the Community level, the OPT story illustrates the relative ineffectiveness of the reference to a bounded territory in the structuration of economic activity. In other terms, the politicisation of economic activity does decreasingly take place along national lines. The OPT networks identified in Chapter 3 are nothing but an illustration of an alternative level of structuration, under the joint influence of institutional and firm-level variables.

It should be made clear that this is not to proclaim the end of national economies, and nation-state. It is in fact, right the opposite. ‘National’ factors such as the home base of firms going abroad²⁷ are crucial determinants of OPT networks. And indeed, national prerogatives were hardly wrested away from member states with the result that strong national traits are a primary characteristic of OPT networks. But that national determinants influence the eventual outcome is not to say that the former are in a position to structure economic activity within

²⁷ See the research agenda of Stopford and Strange (1991), as well as the work produced at the Berkeley Roundtable on International Economy.

national constituencies. The question at stake in this respect, is not whether (national) policy measures have an impact -of course they have- but where, at which level, they impact. In the words of Bernard and Ravenhill,

'while transnational networks organize production in ways that do not correspond to the boundaries of formal political communities, they still exist *concurrently* with the interstate system' [Bernard, Ravenhill, 1995: 184-85]²⁵⁸

This point, in turn, should make clear that it is not the fact that the economic outcome is not systematically 'nationalised' which is interesting per se; this would be merely tantamount to discovering 'internationalisation'. What is of interest, instead, is the implication concerning the bases of the exercise of political authority in economic matters. Indeed, the political control of economic activity is traditionally conceived and exercised within a territory. But on the face of it, the growing irrelevance of the notion of bounded territory means that

'there is not much left of a territorial basis for authority' [Strange, 1996: 45].

Thus, new mechanisms thereby political variables impinge on the organisation of economic activity which are emerging in the wake of the globalisation of the world economy question the conception of a governance system taking place within a bounded territory and stamping its mark over the economic outcome which is at stake. In the words of Cerny, it corresponds to a change in the 'political economies of scale' characterising collective action. Indeed, the former, which refers to the 'calculi of how efficient and effective particular economic and political activities are within particular structural contexts' are increasingly disconnected from national boundaries [Cerny, 1994: 7].

2. New roles of old actors: on the redefinition of the relations between firms and states

As suggested above, calling into question the pertinence of the reference to a territorial constituency as an appropriate level for analysing economic activity has a wider implication for the political control of economic matters. It makes necessary the reconsideration of the nature and the role of the actors party to the game.

One important issue in this respect is the role of the state as one actor of traditional paramount importance which is no longer systematically in a position to stamp the national mark

²⁵⁸ Emphasis added.

over the eventual outcome. This is not to say that the state as an agent of structuration of economic activity has lost all its competence, but simply that the traditional pattern of state intervention in the economic sphere is to be reconsidered.

In Cerny's interpretation, for example, the 'competitive state' is substituting for the more conventional welfare state by focusing its action on microeconomic issues in order to foster competitive rather than comparative advantage [Cerny, 1990]. But this is not enough to pinpoint more fundamentally new tasks performed by states which have a strong influence on the structuration of economic activity.

As a matter of fact, states have developed functions like that of negotiating agent and 'gate-keeper' and engage in a direct confrontation with firms. In a game of 'triangular diplomacy', states bargain with other states, and with firms [Stopford and Strange, 1991]. The inter-state bargain is more easily acknowledged. Indeed, international agreements like the Multi Fibre Agreements have been interpreted in this light: a co-ordinated approach at the international level is adopted to recover competence which existence is challenged at the national level by world-wide economic interdependence:

"national states in response to the pressures of regime competition and the 'tyranny of external effects' resulting from internationalisation under nationally fragmented governance, may try to defend their 'sovereignty' by collective action through international organisation" [Hollingsworth et al., 1994: 291].

In fact, the bargain involves also the business sphere. In the OPT case, it is the Community institutions which provide the forum where such this tripartite confrontation takes place. The direct access of multinational companies to the Commission is one evidence suggesting a shifting system of governance, which could be acknowledged more thoroughly [Coen, 1996].

Symmetric to the reconsideration of the role of the state, is the new 'political' dimension acquired by (big) firms organising their production process across boundaries and deciding upon their corporate strategies on a scale disconnected from that of their national basis. This is an important feature which is however still neglected. Indeed, parallel to the neo-classical neglect of corporations considered to be nothing more than a black box transforming inputs into outputs, firms were conspicuously ignored by political scientist.²⁵⁹ In Vogel's terms, firms were considered to be

²⁵⁹ Indeed, if anything, it was "capital" which was approached in political terms. Another approach to the political dimension of firms proposed by Political Science was proposed through the study of trusts in the United States.

“an anomaly that upsets the balance between democracy and capitalism”²⁶⁰

The acceleration of the mutations at work in the world economy under the aegis of big multinational corporations has put an end to such extremes.

3. The source and the exercise of power

The present study suggests that there is more to the redefinition of states and firms' traditional functions resulting from the globalisation of economic activity. What is at stake is not so much the acquisition of the traditional attributes of power by firms than a move towards the redefinition of the very nature of the power they exercise, accompanied by the growing effectiveness of their authority.

Thus, it is not (only) that firms are growing state-like, taking over functions which were once the exclusive prerogatives of inter-state relations. Fair enough, a picture where big firms engage in a 'bargain' with states, in a game of 'triangular diplomacy'²⁶¹ is already a challenging attempt to bring traditional economic thinking closer to the reality of the functioning of the world economy.

Nor is it (only) that, rather ironically,

“the state (...) is having to act more and more like a market player” [Cerny, 1990: 230].

But it is also that firms, and market actors in general (i.e., not only *big* multinationals) are increasingly endowed with the capability of influencing the economic outcome in a decisive way. In other terms, it corresponds to a shift in the privileged locus of the exercise of power away from the traditional political arena to the market.

The importance of firm-specific variables in the structuration of OPT networks testifies to these general trends. German firms which control their local OPT partners' production chain are powerful simply 'by being there' [Strange, 1996: 26]. They take advantage of a set of constraint and opportunity to extend control over local partners. Control or bargaining power rather than ownership or profit are the key variables for understanding the structuration of 'commodity chains' [Gereffi, 1994].

²⁶⁰ Quoted in Wilks (1996).

²⁶¹ Stopford, Strange, (1991).

Such a type of power is more 'diffuse', more 'impersonal', and accrue to market rather than traditional political actors; but it is certainly not less effective than that referred to conventionally. In one word, it is more 'structural' [Strange, 1994, 1996].

4. The European construction at stake

OPT illustrates the ways in which the European integration process proposes to respond to the mutations at work in the world economy. But by calling into question the validity of the mechanisms of governance underlying the process of European integration, it invites to depart from a territorially-based conception of governance for managing growing economic interdependence.

Bringing the argument to its end is particularly interesting as far as the problematique of enlargement is concerned. As a matter of fact, fears of enlargement are justified on the basis of the dissolution of centralised political competence over an enlarged area. This view thus implicitly takes over a conception of governance of the economy intended in its most traditional sense: territoriality matters.

The problem is that if such a view implicitly underlies most discussions on enlargement, it is not fully acknowledged, making the arguments in favour of delayed membership often specious. For example, the purported neutrality of economic liberalisation justifies the fact that political membership is postponed²⁶²: considering the two to be separate issues is indeed a clever contrivance to procrastinate eventual memberships.

On the face of it, dropping the cumbersome principle of congruence makes it possible to ground the process of political integration on an alternative rationale, and to proceed with alternative forms of political interdependence. Thus, if it does not mean the replication of the nation-state model, the way is paved for an unconditional support of the process of enlargement.

This has a wider relevance for the European integration process as a whole. If the traditional mechanisms of governance are not the only possible ones ... it is worth focusing on where politicisation happens effectively. In short, in the face of an irredeemable loss of competence of the political authority in some specific economic matters... identifying alternative

²⁶² The future developments of the process are indeed at best indeterminate. Displaying high degrees of versatility, going from the promises of further sounder promises (...) to sudden cooler positions (The Economist Nov. 1995), officials from the Community have not yet set up a definitive schedule for integrating their Eastern neighbours. It is commonly agreed that the main difficulties preventing from clear-cut positions have to do with the excessive budgetary costs associated with the extension of some sensitive common policies (mainly the Common Agricultural Policy, and the participation to the regional structural funds).

areas where the influence of political action is still (or newly) effective is more constructive than to endeavour in replicating all over the same recipe, irrespective of the mutations at stake in the world economy.

6.4 The Last Words

The political governance of economic interdependence depicted in the dissertation is a response to the complaint that globalisation brings about the depoliticisation of economic activity. Indeed, there is a tendency to associate the emergence of such new forms of economic structuration with the progressive retreat of politics: the loss of economic sovereignty over the national constituency by the state is equated with the prevalence of economic and technical factors. In this view, globalisation produces a unique pattern of behaviour, determined by a 'pure' economic rationality where technology would be one of the main driving force. Hence the (implicit) refutation of the assumption of the indeterminacy of the final outcome on the basis of economic factors alone.

However, the new functions endorsed respectively by states and firms, together with the redefinition of the nature of power over economic matters moderates the hypothetical retreat of politics. Rather, globalisation questions traditional modes of governance: globalisation is not so much a cause of 'depoliticisation' of economic activity; it rather brings about new forms of politicisation.

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