CEPII
CENTRE
D'ÉTUDES PROSPECTIVES
ET D'INFORMATIONS
INTERNATIONALES

No 1993 – 04
September

Regional and World-Wide Dimensions of Globalisation

Michel Fouquin

REGIONAL AND WORLD-WIDE DIMENSIONS OF GLOBALISATION

Michel FOUQUIN

Document de travail n° 93-04

Septembre 1993

SEMINAR ON DEVELOPMENT AID AND FOREIGN INVESTMENT

Beijing 28th of June - 1st of July 1993

CONTENTS

SUMMARY

Since the Second World War, western governments have implemented trade liberalisation policies which have been very successful and have spread across the rest of the globe. However, some countries have remained outside this general movement because of national policies aimed at self-reliance, or because of the debt crisis, or falling commodity prices, the combination of which has reduced the purchasing power of developing countries, with the exception of those in East Asia.

The degree of internationalisation has also varied across sectors. Trade is most extensive in electronic, textile and petroleum products, while other products (cement, food, electricity, domestic and public services) are, by their very nature, more difficult to trade. However, even in these sectors there has been a marked trend towards internationalisation as a result of deregulation and direct investment.

But despite these successes, trade liberalisation is still encountering many difficulties, as the Uruguay Round negotiations demonstrate. New forms of protectionism are spreading, and regional agreements are being strengthened. In view of the growth of regional agreements, especially the Single European Market and the North American Free Trade Agreement (NAFTA), a decline of multilateralism is to be feared. That said, foreign trade is expanding primarily between countries that are closest to one another in terms of their level of development and geographical proximity. Regional integration is thus making substantial progress in Europe -both between EEC Member countries and between EFTA and the EEC- and also in North America as well as between the "three Chinas". This is a natural phenomenon that does not threaten multilateralism. The institutionalisation of relations merely makes it possible to speed up the process of liberalisation. Indeed, it can even be argued that the progress of regional integration can constitute an intermediary stage in the opening-up of sectors previously sheltered from international competition.

The nature of internationalisation has also changed; the world economy is evolving into a deeply-integrated system. During the 1980s, this process was speeded up by the liberalisation of international capital movements and the technical advances in telecommunications and computers. Internationalisation is thus gradually giving way to a globalisation of the world economic system, reflected especially in the growth of

multinationals. Little by little, firms are losing their national base and are elaborating their strategies in global terms.

However, mounting unemployment in Europe, instability in Russia, the emergence of new actors such as China, and the worsening of the situation in Africa, pose a serious threat to the integration of the world economy. Increasingly, the lack of an international monetary system is causing large erratic swings in the relative values of currencies. How can one talk about fair competition when the value of a currency can double without any real justification? These strains could lead to the break-down of the free-trading system and the outbreak of a full-scale trade war.

Globalisation is said to be a phenomenon based on the MNC's autonomous development of a world strategy. In fact when looking at different experiences it can be seen that there are very different practices. American firms tend to be truly globalised firms. In contrast, Japanese firms keep a very strong national base and play the global game in production only when there is no other way to expand. What can be said of the NIC's? They have experienced both FDI as host countries and as outward investors in other Asian countries. There may be two different stories, with Korean firms playing the game rather as Japanese firms, while Taiwanese firms are playing a more truly global game.

INTRODUCTION

The 1980s saw both progress and problems in multilateralism and regional integration. Multilateralism made headway in the developing countries an increasing number of which GATT principles and brought their trade legislation into line with them. And with China and Taiwan likely to join in the next few months or, at the latest, in the next few years, the GATT will become genuinely world-wide. Unquestionably, this is a major success. However, it is also clear that the GATT mechanism in threatened with paralysis and seems incapable of evolving. In particular, it seems that the latest Uruguay Round negotiations may well not be concluded rapidly despite the considerable efforts and concessions made on both sides of the Atlantic.

At the same time, and almost in parallel, some regions have made substantial progress with their schemes for integration. In particular, the two main protagonists in GATT -- the United States and the European Community -- have embarked upon major projects, respectively NAFTA and the Single European Market. The latter is eventually to be followed by Economic and Monetary Union (EMU) -- attesting a new resolve to achieve far-reaching regional economic integration.

Regional integration thus seems to have been making progress to the detriment of multilateralism. However, the EEC has also been experiencing serious difficulties, if only in the monetary area. Since the crisis in September 1992, the EMS has been in danger of breaking up: the resulting uncertainty could call into question the objective of a single European currency set by the Maastricht Treaty.

More or less everywhere, countries which are in difficulty seem to be questioning whether it is timely to pursue the GATT or regional negotiations. If nationalism or protectionism were to prevail, both regional integration and globalisation would probably suffer[1].

[1] Regional integration can be regarded as a stage in a long and general process of the unification of markets, first at national and then at regional level. In France, the 1789 revolution abolished internal frontiers and established a single external frontier and currency. It also abolished corporatism. In Germany, the unification of the natinal market dates from the introduction of a customs union in 1934 and the introduction of a low common external tariff. In 1860, France and United Kingdom signed a free trade treaty that made possible a lasting reduction in French customs duties; on average, they remained under 10 per cent up to 1930. The 1929 crisis and the Second World War greatly increased protectionism, the consequences of which took comprising a few developed countries. Initially, it was a body that had only a limited regional competence. It took nearly h alf a century to become a worldwide organisation. The European Community had six members in 1957; by 1985 it had twelve, and the accession of Austria, Sweden and Finland is now on the agenda, not a mention potential applications from the Eastern European countries, Turkey, Cyprus, Malta and Morocco. Increasingly, the six founding members of the Community will have to determine how to organise various circles of solidarity based on geographical proximity.

In addition to an institutional analysis, which makes it possible to say that both regional integration and multilateralism have made parallel progress, an economic analysis is also required. This is the purpose of this paper.

x x

x

Part 1 seeks to measure the degree of internationalisation of the various areas of the world economy, primarily via merchandise trade.

Par 2 highlights the regional share of internationalisation as far as visible, services and direct investment are concerned.

Part 3 seeks to measure the phenomenon of globalisation and deep integration.

Part 4 examines different ways to globalisation

1.. GROWING ECONOMIC INTERDEPENDENCE

1.1. Growing interdependence

The economics direct developed countries interdependence has grown considerably in the past thirty years. Comparing flows of trade goods and services with total OECD GDP measured in current dollars shows that the ratio rose by 50 per cent -- from 12.2 to 18.7 per cent -- between 1966 and 1990 (Diagram 1).

Diagram 1: Share of trade in goods and services in world GDP.

However, the rate of growth of interdependence has varied over time across economies, fluctuating sharply in the wake of the oil shocks and relative changes in currency parities. But the overall trend is not in doubt. Furthermore, the two benchmark years -(1960 and 1990)-

were more or less "normal" in terms of the economic situation -- which was rather favourable -- and with respect to currency parities, although the dollar was probably slightly lower in 1990 than in 1960. It can even be argued that the indicator used tends to understate rather than overstate the degree of interdependence. If we compare the trend of trade prices with that of the GDP deflator (Table 1), we see that trade prices grew less rapidly. In thirty years, relative import prices (i.e. relative to GDP prices) fell by an annual rate of 0.7 per cent, or 23 per cent over the period 1960-1990. Interdependence by volume is thus nearly a quarter higher than interdependence by value. The fall in relative international trade prices has two main causes:

1. as internationally-traded products are the most competitive, their prices rise more slowly than domestic prices;

2. the structure of internationally-traded products contains more products whose prices fall than does the structure of goods and services consumed in the domestic market (for example, the relative prices of commodities have fallen, while the relative prices of services have risen everywhere).

Table 1: Comparative trend of domestic and trade prices (average annual rates of increase)

1.2. Varying degrees of interdependence from one country and area to another (see Diagram 2)

Although countries have become much more interdependent, some countries have escaped the general trend, while the nature of interdependence has varied from one geographical area to another. Japan is a striking exception to the general trend; At first sight, its import penetration ratio (imports of goods and services/GDP) was stable at around 10 Per cent between 1960 an 1990 (respectively 10.2 and 10.1 per cent). On the basis of the relative changes in import and GDP prices, the trend of relative prices in Japan seems to have differed little from that in Europe.

Diagram 2: Share of imports of goods and services in regional GDP

There were two main reasons for the stability of the rate of import penetration in Japan. First, Japan has to import raw materials. However, the demand for primary products is in structural decline in a developed country geared increasingly to high-technology, low-raw material-intensive industries. The second factor is the specific nature of market structures in

Japan, especially the integration of distribution channels inside the Keiretsu, which makes it difficult for foreign manufacturers to break into the Japanese market.[2]

The United States was not a very open economy before 1960, but since then it has had an import penetration ratio similar to that of Japan. Given the relative size of their economies, it may be inferred that the US economy is much more open than the Japanese economy. In fact, the size of a country's domestic market is a crucial factor in the degree of openness of its economy. The larger a market is, the more it tends to be self-sufficient. Economies of scale become possible in many sectors. In contrast, the smaller the economy, the more open and specialised it is in the production of a few products. There is a strong, if not rigorous, relation between the two (Diagram 3). The US market has thus become much more open while the Japanese market is still relatively closed.

Diagram 3: Degree of openness of economies, and the size of their markets

The domestic markets of the EEC and EFTA countries have been opened up at least as much as the US market (Table 2), though not to the same countries. In the case of the United States, the main beneficiaries of the opening-up of its market have been the Asian countries -- Japan and the four NIEs -- followed by Latin America, while the European countries have turned away from their ex-colonies in Africa and the Middle East to concentrate on intra-area trade. Non-European countries now account for 40% of Europe's international trade, while intra-European trade accounts for 60 per cent (Diagram 4 and 5). However, it cannot be said that the construction of Europe has been to the detriment of the non-European countries, the latter having maintained their share of a market that expanded rapidly between 1960 and 1973. In fact, the most distant Asian countries -- the most affected by protectionism -- even increased their market share to the detriment of Europe's traditional suppliers (Africa, the Middle East and even Latin America (Table 20)), which often have preferential access to the EEC market. The demise of the colonial empires is the main, but not the sole, explanation for this. Also, the former colonies have not succeeded, by and large, in becoming industrialised countries, and are still commodity exporters. In addition, they have been and continue to be, trapped in debt, which further diminishes their weight in the world economy.

Diagram 4: Intra-EEC (the Twelve) trade

Diagram 5: EEC exports to, and imports from, the rest of the world

---

[2] M. Fouquin, "L'autoprotection de l'industrie japonaise" in "Le protectionisme", directed by H. Bourguinat, Economica, 19985.

Table 2: Developing Asia's share of EEC imports

Broadly speaking, countries in crisis (in Latin America, Africa and the Near East) have put up barriers to international trade, while those (in Asia) that have experienced strong growth have opened up their economies to international trade on a large scale.

1.3. Varying degrees of interdependence from one sector to another

While the interdependence of the developed and Asian countries has increased overall, it has varied according to products and sectors. In the case of world merchandise trade (Trade 3), it may be noted that interdependence with respect to energy products has fallen by volume, and it has also falter with respect to agricultural products, though to a lesser degree. In both sectors, world output has grown more rapidly than trade, which means that, overall, countries have become more self-sufficient.

As regards energy, it is clear that the oil shocks prompted countries implement energy-saving measures -- especially for imports -- as well as energy substitution measures; and, whenever possible, to export all available national resources. As a result, international energy demand fell.

As for agriculture, national policies, coupled with the regional policies of the Common Agricultural Policy (CAP) in Europe, have made most economies and regions of the world more self-sufficient, causing international trade to grow more slowly.

Conversely, the manufacturing sector is clearly at the heart of the growing interdependence between economies, especially among the industrialised countries. It is also the sector that has permitted the emergence of the Asian countries as major exporters. The average domestic demand elasticity of demand for trade in manufactures is 1.5. In other words, when world demand (or output) increases by 1, trade volumes increase by 1.5 (Diagram 6),, regardless of any projectionist measures that may have been taken. Despite the increase in protectionism barriers, this elasticity seems unlikely to decrease.

Diagram 6: Growth of industry and international manufacturing trade 1950-1990

Looking closely at manufacturing trade, it can be seen that its intensity varies widely across sectors. For example (Diagram 7) electronic products are the most heavily traded, while construction materials are the least traded relative to the value of world output of such goods. For electronic products, the ratio of trade to turnover (estimated flows by value is 45 per cent; for construction materials, the corresponding ratio is only 7.5 per cent. Relative trade intensity is largely a function of the nature of the industries in question. Some are very highly integrated; in contrast, others may be split up into numerous more or less autonomous production segments. Some products are easy to transport, others not. In the case of electronics, the lightness of the products and the number of components needed to manufacture the final products, and the different nature of the various stages of the production process (e.g.: the labour intensiveness of assembly and the extreme technology intensiveness of etching components) are conducive to an extensive international breakdown of production processes. In contrast, cement is a heavy, low-value-added, standardised product which is usually made close to its point of use (the same is also true of the agro-food industries).

Diagram 7: Foreign trade exposure of individual industries

It is thus not surprising that the countries with the highest international trade exposure are often also those that have specialised in the manufacture of products which are traded very intensively. For example, the Asian countries penetrated international markets primarily via electronics which is the most internationalised sector.

There is little international trade in services, since by their very nature they are difficult to trade. Excluding interest paid on countries' external debit (Table 3), the share of services -- including net capital movements -- in international trade is very small, only about 10 per cent, has not increased since the late 1960s. In other words non-factors service international trade is flat rather than growing. Also, over the same period, share of services in employment and value added in the developed countries has been growing substantially, which means that, all told, the ratio of trade to production fell.

Table 3: Structure of world trade by category of transaction (credits)

Investment income is the only item that has increased steeply: up from about 7 per cent of total credit flows to more than 14 per cent in 1990. There are at least three explanations for this. First, the oil shocks and OPEC's financial surpluses fuelled Third World debt. Second, higher real interest rates hugely increased the repayment burden to the oil-producing countries. Third, the liberalisation of capital movements spread to Europe, facilitating (to a certain extent) the internationalisation of the financing strategies of both developed countries and multinational industrial companies. The growing share of financial earnings thus also reflected genuine internationalisation, not just higher interest rates.

Clearly, however, the internationalisation of services cannot be measured properly from trade flows. By their very nature, many services are not traded since they are used at their point of production, thereby making it difficult to measure trade in them. For example, a restaurant-owner does not report the nationality of the customers who have lunch in this restaurant.

To sum up, it may be said that the regional dimension is an essential component of the internationalisation of some economies, and of Europe in any case. Also, the scale of internationalisation cannot be measure properly through trade flows only. These two aspects will be dealt with in the following section.

2. REGIONAL INTEGRATION VERSUS MULTILATERALISM?

2.1. Regional trade integration: a natural phenomenon

Classical (Ricardo) and neo-classical (Heckscher-Ohlin) theories explain international trade by differences between nations and sectors -- Ricardo by differences in relative productivity. Heckscher-Ohlin by differences in factor endowment. According to these theories, different countries specialise in different industries. Broadly speaking, these theories provide a satisfactory explanation for colonial-type trade between countries in products that are complementary (raw materials in exchange for manufactures) rather than substitutes, or between countries with very different wage costs (textiles from the newly-industrialising Asian countries for machines from the developed countries).

Despite its importance, however, trade in complementary products is declining. Oil is still a vital product for developed countries but its share in world trade is falling. Countries that rely primarily on commodity exports (Australia, New Eland, Russia and the oil-producing countries among others) are in difficulty, while the new exporters of manufactured goods have broken into world markets in a spectacular fashion. Correlatively, most international trade now consists of trade in substitute products between developed countries. Furthermore, trade in similar products between countries in the same area is a major component of trade. Highlighted by Linder, the latter phenomenon is at the very basis of regional integration. How can it be explained? The demands of consumers and manufacturers are increasingly sophisticated and varied. For example, in the 1920s there were only a few models of mass-produced cars in the US market (notably the famous Ford T model). Today, in addition to the three US car-makers, ten foreign car-makers have a massive presence in the US market , offering a wide range of vehicles with numerous different engines, electronics and body-work options. Consumers have become much more demanding will regard to variety. Similarly, manufacturers are setting increasingly demanding technical specifications, obliging suppliers of basic components to tailor them to the individual requirements of each user.

Because consumers and manufacturers demand greater variety, trade in similar products has expanded considerably. The car industries in Europe and Japan have become very big exporters, while all markets (except Japan) have become big importers. A pattern of trade dominated by intra-industrial trade between countries at a comparable level of development is thus emerging: it is particularly marked in Europe.

2.1.1. Regional integration in Europe

a) The EEC

The institutional construction of Europe is a dynamic process that has been going on since 1951. The history of this construction, the main stages of which are summarised in Annex 1, shows that the EEC has transformed itself by a process of enlargement (from six to twelve members) and deepening (from the initial Customs Union to the Economic and Monetary Union provided for by the Maastricht Treaty, which it is planned to be completed by 2000). Although the treaty is not clear on this point, some form of European federal state should eventually emerge. While a large majority of European business leaders are in favour of this evolution, it is nonetheless clear that the construction of Europe owes most to the resolve of European policy-markers to ensure that the conflicts that led to two World Wars will not happen again, and to create a political force capable of negotiating on equal terms with the United states.

Annex 1: Main stages of the construction of Europe (EEC)

The 1986 Single European Act and the project for Economic and Monetary Union introduced a new dimensions into the process of integration, which goes far beyond a mere Customs Union. The complete freedom of movement of goods, services, capital and persons between EEC member countries, coupled with a single currency, should lead to the full integration of the various markets. In the long term, the prices of goods and services, capital and labour should be the same in all national markets. No other regional project is therefore comparable with the EEC. What effects will this integration have?

First, it is necessary to assess the record over more than thirty years.

As noted earlier, intra-industry trade is the most developed form of trade, especially between EEC members.

Intra-industry trade is usually measured by Grubel and Lyod's indicator. This measures, for a given product k, the relative intensity of two-way trade in products of the same category, so that:

$$GLk = 1 - \frac{|Xk - Mk|}{Xk + Mk}$$

the aggregated global indicator is then:

$$GL = 1 - \frac{\sum_k |Xk - Mk|}{\sum_k (xk + Mk)}$$

This can be adjusted for the effects of trade balance disequilibria, follows:

$$GLC = GL \frac{\sum (Xk + Mk)}{\sum (Xk + Mk) - \sum |Xk - Mk|}$$

In the author's view, the usual interpretation of this indicator can be challenged[3]. The indicator measures the intensity of international specialisation: the larger the sectoral imbalances, the lower the indicator. In contrast, if trade is balanced, product category by

[3]Usually, it is considered to measure intra-industrial trade. But in fact it is not at all evident that it does, since there are no grounds for claiming that sectoral trade involves homogeneous products.

product category, the indicator tends to unity. The figures in Table 4 were calculated by the OECD. They clearly confirm the argument that sectoral trade between European countries - Germany, France, Italy and the United Kingdom) is usually more balanced than trade with the United States, Japan and Canada.

Table 4: Bilateral intra-sectoral trade indices, all products

Over the period 1970-1990 this indicator showed also a sharp increase in reciprocal trade, and thus a reduction in sectoral imbalances between European countries. Conversely, it shows that in three out of four cases sectoral trade imbalances with Japan worsened. European integration has thus resulted in an easing of sectoral imbalances and reduced inter-industrial specialisation.

We also tried to measure very precisely the share of trade in similar products in the foreign trade of two EEC countries (France and Germany). To do so, we calculated the unit values of traded products for a 9500-position nomenclature. Products were considered to be similar if the unit values of exports and imports differed by less than 15 per cent; otherwise, the trade was considered as being of different product ranges: from luxury products to standard products[4]. Also, trade was considered to be one-way when the smaller flow was less than 10 per cent of the larger flow; otherwise, it was considered to be two-way.

Table 5 shows that, in 1989, two-way trade in similar products represented about 41 per cent of the total trade of the German Federal Republic, and 45 per cent of France's trade, while the proportion of one-way trade was 27 per cent for both countries. Trade in similar products therefore predominated. When trade in different ranges of products is included, intra-industrial trade accounted for approximately 70 per cent of the total trade of both countries.

Table 5: Breakdown of the foreign trade of the Federal Republic of Germany and France in 1989, by type of trade

The same analysis can be carried out for the geographical destination of flows. Here, we took the EEC and the partner country (France for the Federal Republic of Germany, the Federal Republic of Germany for France) with the rest of the market. Table 5a shows that the share of one-way trade in each country's trade with the EEC is smaller than with the rest of the

[4]This gives a fairly precise measure of trade in similar products, which underpins the theory of intra-industrial trade. For further details see: M. Freudenberg and F. Müller, "France et Allemagne: quelles spécialisations commerciales?", in Economie Prospective Internationale, n° 52, 4thuater 1992, La Documentation Française, Paris.

world, and even more so in each country's trade with its partner. Thus, the Federal Republic of Germany's share of one-way trade falls from 27.2 per cent with the rest of the world to 23.0 per cent with the EEC and only 19 per cent with France, a difference of 8 percentage points. Essentially, it is the share of bilateral trade in similar products that rises considerably -- 31 per cent for both countries, or twice that with the rest of the world (13.9 per cent).

Table 5a: Breakdown by area

The similar structure of the trade of France and the Federal Republic of Germany is striking, all the more so in that the relative size of their industries is very different.

The general conclusion that can be drawn from the foregoing remarks is that geographical proximity results in intense trade in similar products, and that with the advent of the Single market and ultimately the Single Currency, this phenomenon will become even more marked.

b) EFTA

EFTA was set up in 1960. Initially, it comprised those European countries that did not want to join the European Community because of the strong political implications. EFTA, in contrast, was merely a free-trade area that fully respected the sovereignty of each of its members. To a certain extent, it was intended to serve as a counterweight to the EEC. In practice, however, it was gradually emptied of substance, first because a number of its members (the United Kingdom, Denmark and Portugal) left it to join the EEC, and second because the EEC, and especially Germany, was a stronger pole of attraction. Thus, Switzerland's main trading partners are Germany and France (see Diagram 8) and not Austria. The EFTA countries have embarked upon a process of integration with the EEC via various treaties, notably by joining the European Economic Area (only Switzerland being opposed), that could precede full membership of the European Community. Austria, Sweden and Finland have started negotiations with the EEC to this end. The advantage for these countries of joining the Community would be that they would have a say in drawing up EEC rules which, increasingly, are being imposed upon them.

Diagram 8: Main trade flows in western Europe in 1989 *c) Other European countries*

More and more countries want to join the EC, but various obstacles stand in the way of their doing so rapidly (i.e. by the end of the century). The main obstacle is economic. For the former socialist countries of Europe, a prerequisite for their joining is the success of the economic reforms that they have launched. In the meantime, association agreements have been signed to permit their economic integration with western Europe. In the case of Turkey and Cyprus, there are also political obstacles (the Cypriot question).

2.1.2. Regional integration in North America

Prior to the signature of the North America Free Trade agreement (NAFTA), trade between the United States and Canada, and between the United States and Mexico was primarily determined by international policies and geographical proximity; considerations of regional integration did not enter into it (Tables 6 and 7).

NAFTA aims to abolish the impediments to trade between the three countries of North America: Canada, the United States and Mexico. Customs tariffs (which average 10 per cent on the Mexican side) and quotas will be abolished when the agreement comes into force on 1 January 1994 for 80 per cent of traded products, and for the remaining 20 per cent in 5, 10 or 15 years, depending on the products[5]. Several sections in this agreement deal with sensitive sectors for which special provisions were deemed necessary.

Rules of origin are defined precisely so as to deny third countries the benefits of the agreement. In the case of textiles, these rules are highly protectionist: to benefit from NAFTA, it is not enough that an article of clothing be assembled in one of the three countries; the fabric and fibres used to make it must also come from one of them. As for the automobile sector, vehicles must have a local content of 62.5 per cent, a rule that has already given rise to a major dispute between the United states and Canada[6]

---

[5]"Analyse mexicaine de l'ALENA", French Emabssy in Mexico, September 1992.
"A report to the President...", by the Advisory Committee for Trade Policy and Negotiations (ACTPN), roneo, Sseptember 1992.

[6]The dispute, which arose in connection with the way in which the US customs wanted to treat Honda vehicles assembled in Canada, has now been resolved. The method of calculating local (North American) content has been defined precisely; the practice of so-called "rounding off" has been abandoned. Previously, the US customs considered that if 60 per cent of the components of an engine were imported from Japan, then the engine was entirely Japanese. By adding up components in this way, they estimated that Honda vehicles assembled in Canada were of 60 per Japanese origin, whereas the Canadian estimate was 40 per cent. For a vehicle to qualify as being Canadiann, the proportion must be under 50 per cent.

Under the agreement, Mexico has made substantial concessions on agriculture. In view of the importance of this sector to Mexico (accounting for 30 per cent of employment), it has been given a very long period to adapt to the provisions of the agreement. Also, NAFTA officially recognises the Mexican Government's right to implement a vast programme of agricultural modernisation. Only export subsidies, save those for exports to third countries, are excluded.

More advantageous -- especially for Mexico -- are the changes in the rules on direct investment. Mexico has waived all export obligations for US and Canadian investments in Mexico. However, a few quantitative restrictions will be maintained in some sectors until 2000. For example, in the banking sector the turnover of the Mexican subsidiaries of North American banks must not exceed 8 per cent of the domestic market in the immediate future, and not more than 15 per cent in the first six years of operation of the agreement.

NAFTA will not have a dramatic effect on Canada, with which the United States initiated its new trade policy on the continent by the signature of a free-trade agreement in 1988.

For Mexico, however, it marks a sharp break with more than a century of distrust of its powerful neighbour, the United States. Increasingly nationalist policies had resulted in a number of absurd regulations such as multiple exchange rates and widespread bureaucratic controls on imports. The 1982 financial crisis and resulting deep economic slump had set back the country's development. Years of economic decline finally convinced Mexico's political leaders of the need for sweeping economic reforms. The ambitious privatisation programme which accompanied these reforms yielded nearly US$ 130 billions to the State budget. The reforms also allowed Mexico to benefit from the Brady debt reduction plan. Mexico's signature of NAFTA was the crowning-point of this transformation and gave potential investors a guarantee of political stability and sound macroeconomics management[7]

For the United States, NAFTA is an addition to an increasingly complex strategy designed to restore its trade balance. This strategy is evident at all levels: globally, via the depreciation of the dollar; multilaterally, as we have seen, in the Uruguay Round talks; regionally, with NAFTA; bilaterally, in the Structural Impediments Initiative (SII) conducted with (or against?) Japan. NAFTA enables the United States to achieve three objectives: first, to reinforce economic integration with its neighbours without having to make any political or

[7] "Les effets conjoints du plan brady et de l'ALENA : le cas mexicain", J.C. Berthélémy and E. Girardin, Revue d'Economie du Développement, n° 2, to be published, 1993.

monetary concession in return[8]; second, to consolidate the Mexican reforms, which could serve as an example to the entire Latin American continent, for which the United States feels responsible; third, to send a warning to the low wage-cost Asian countries of what will happen if they do not make an effort to open up their markets.

The integration of the Mexican, Canadian and US economies is already well-advanced: intra-area exports rose from 42.5 per cent of the three countries' exports in 1967 to 44.7 per cent in 1990 (Table 6). On the other hand, the area's share of imports fell sharply, from 42 to 34.5 per cent (Table 7).

However, integration in NAFTA is very asymmetrical: while Canada and Mexico rely on the North-American market for more than 75 per cent of their foreign trade, they account for only 25 per cent of the foreign trade of the United States. Furthermore, Mexican exports have a very high US content (51 per cent in 1989); as for Canada, in 1988 39 per cent of manufacturing output was made by US affiliates enterprises[9]

US export dependence on the other signatories of NAFTA fell by 2.6 per cent from 1967 to 1990; Canada's export dependence was unchanged but that of Mexico rose to 85.9 per cent. All told, it is the opening up of the US market to Mexican products that has increased the inwardly-directed nature of NAFTA trade.

Table 6: Matrix of exports of all products as a percentage of total exports of each exporting country

Table 7: Matrix of imports of all products as a percentage of total imports of each area (1990 levels)

At the sectoral level, the pattern of national specialisations is very different from one country to another. Differences in size, level of development and natural resource endowment result in very different patterns of specialisation. Canada and Mexico export only a small number of products in large quantities, but import a very wide range of products. Because they are relatively small, the Canadian and Mexican sectors that are big exporters are also the most dependent on the US market: on average, 90 percent of the ten main categories of products

[8] It is this that fundamentally distinguishes NAFTA from the EEC, which is in constant flux.

[9] "Economie mondiale 1990-2000: l'impératif de croissance", report of the Centre d'Etudes Prospectives et d'Informations Internationales" (CEPII), Economica, 1992.

exported by Canada go to the United States. The same is true for Mexico if crude oil is excluded.

In contrast, the US exports are highly diversified and not directed particularly to Canada or Mexico, except for automobile exports: 83 per cent of US exports of vehicle components are to Canada and Mexico. The same is true for exports of complete vehicles and commercial vehicles. The automobile sector is regulated by an agreement signed by the United States and Canada in 1965. At that time, Canada was protectionist, and, under an agreement concluded with the United States, the bulk of the assembly of US vehicles which were to be sold in Canada had to be carried out in Canada. As the Canadian market was very protected, this was the only way to sell cars there. The agreement has now been extended to Mexico and should give a strong boost to Mexican production and demand[10]. Apart from automobiles, however, US exports are strong worlwide and not just in North America.

Canada and Mexico have a high import dependence on the United States, the degree of which is more or less the same across all sectors. The products for which they are most dependent on the rest of the world are also similar: specialised machinery, electronic components, yarns and fabrics, telecommunications equipment, consumer electronics, machine tools, photographic equipment, beverages, and pharmaceuticals, in which the United States no longer has a comparative advantage in this case geographical proximity overcome the loss of competitiveness. Leaving aside automobiles, US imports from Canada and Mexico are mainly: crude oil, paper, natural gas, non-ferrous metals, agricultural products and refined petroleum products.

NAFTA is unlikely to cause the basic picture to change, but it could, accentuate specialisation. It is in the interest of the United States to reinforce the security of its raw material supplies, even if Mexico maintains its exception regarding oil.

Numerous simulations of the effects of NAFTA have been made with computable general equilibrium models[11]. They show clearly that the overall impact will be limited, except if the effects on direct investment are included. The expected gains in terms of GNP range, on various assumptions, from 0.1 to 11 per cent for Mexico, 0.1 to 2.6 per cent for the United States and 0.0 to 6.8 per cent for Canada, the upper limit including the effect on direct investment. However, there will be sectoral and regional exceptions: labour-intensive

[10] "Economy-Wide Modelling of the Economic Implications of AFTA with Mexico and a NAFTA with Canada and Mexico", United States International Trade Commission Publicatin, n° 2508, May 1992, Washington DC.

[11] "The Automobile Industry and the Mexico-US Free Trade Agreement", S. Berry, V. Gilli and F. Lopez-de-Silanes, NBER Working Paper, n° 4152, 1992.

industries in the south of the United States have started to migrate south of the Rio Grande. Moreover Mexican peasants can expect a veritable electroshock: it is estimated that between 600 000 and 700 000 persons will have to quit agriculture.

Although the impact of the economic integration of North America on the United States will not be negligible, it will not replace multilateralism. Instead, it forms part of an overall plan to strengthen US interests. Whether in the GATT, NAFTA or bilateral negotiations with the Asian countries, it is the United States that initiates the negotiations and makes most of the proposals;

Regardless of the ultimate outcome of the various regional and multilateral negotiations under way, it is clear that the United States, despite or because of its relative economic decline, still has the initiative at world level. Although the EEC is now able to stand up to the United States to some extent, it is still largely incapable of proposing another vision of international economic relations.

2.1.3. Regional integration in Asia

Unlike the EEC and NAFTA, the free trade area constituted by the Association of South-east Asian Nations (ASEAN) does not crown a trend towards interpenetration. For the past ten years, intra-ASEAN trade has been modest (less than 20 per cent of total imports, due to the fall in Indonesian crude oil exports to Singapore) (Table 8).

Table 8: Share of intra-East Asian trade in East Asian trade

Instead, the economic integration of the ASEAN countries is taking place via other means: direct investment by other Asian countries, Japan and the Asian Newly-Industrialising Counties (NICs) (Table 9 and 10).

Table 9: Shares of intra-Asian and intra-ASEAN trade in ASEAN trade

Table 10: Breakdown of the stock of foreign investment in industry by country of origin (ranking in brackets)

As part of the movement towards a strictly vertical division of labour, Japanese firms switched their most labour-intensive production from Japan to the Newly-Industrialising Economies (NIEs) in the 1960s and 1970s, while today they are setting up plants in China and the ASEAN countries. Japan, followed by the NIEs, has specialised in the manufacture of more complex products. As this division of labour is gradually put in place, flows of parts and semi-finished products from the more developed countries to the less developed countries expand; the less developed countries assemble the parts and export the finished products to the more developed countries. This is why ASEAN trade with North America is growing.

Direct investment by the NIEs in Asian countries is as substantial as that by Japan. The overseas Chinese account for half of foreign investment in China. The trade of Japan and the NIEs with North America is decreasing (in relative terms), while their trade with the ASEAN countries, and especially China, is increasing.

2.1.4. Prerequisites for regional integration

In most cases, regional trade has grown after each of the participants has carried out economic reforms to reduce the State role in the economy and to promote greater economic freedom, especially with regard to international investment. For example, Mexico carried out economic reforms well before it concluded regional agreements. Similarly, Indonesia was able to envisage signing the Asian Free Trade Agreement after implementing a programme of economic reforms from the mid-1980s.

As for China, it is clear that without the 1979 reforms and the success of the special economic zones, it would not have been able to extend gradually the policy of reform, and to open up larger and larger areas of the country, including Shanghai, its industrial heart, to the outside world. Similarly, the opening-up of the economy has enabled trade with Taiwan to expand at an extraordinary speed.

Thus, rather than being opposed to multilateralism, it seems rather that formal and informal regional integration should be regarded as an experimental stage that makes it possible to test whether the opening-up of trade will be beneficial or not.

2.2. Regional integration of trade in services

With the exception of tourism, the structure of US trade in services (Table 11) is very different from that of its merchandise trade. NAFTA's share of services is less than half (10 per cent) of its share of merchandise trade and tourism (some 27 per cent). Western Europe is the main beneficiary of this situation. More specifically, the table shows that Europe accounts for a preponderant share of technology earnings, freight and passenger transport, and other services, as well as investment income which is a US outlay. From the revenue angle, its share is less preponderant. This geographical specialisation can be explained by the scale of the investment flows by US multinationals in Europe, and by European multinationals in the United States. US firms decided to set up in Europe from the mid-1960s, mainly in order to maintain or increase their European market share. They did so in sectors in which they enjoyed a major technological advantage. Thus, US technology advance was exploited to a large extent via trade in services and investment income rather than the through direct export of goods. The features of the US balance on services with Japan are less marked; at the most, it may be noted that the United States has a very clear advantage in tourism and passenger transport. US firms exception electronics have not managed to create a strong presence in Japan. One only has to recall the difficulties that IBM and Texas Instruments encountered at the start of the 1970s in setting up Japanese subsidiaries wholly-owned by the US parent company. Since then, legislation has opened up the market to a certain extent, but it is still difficult to set up or acquire a firm in Japan, as recent experience has shown.

Table 11: The regional structure of US current transactions in 1991

Foreign direct investment in Japan is still extremely modest compared with that in other developed countries. In 1989, foreign firms accounted for only 2.4 per cent of the sales of Japanese manufacturing industry, compared with 14.9 per cent in the United States, 22 per cent in Germany, 24 per cent in the United Kingdom and probably 28 per cent in France (see Part 3).

In 1991, Asia was Japan's main trading partner, on an almost equal footing with North America (United States and Canada), with the European Community a long way behind. For services, the ranking was different: North America was in first place, followed by the EEC in second place and Asia in third place. Asia's small share of trade in services is primarily ascribable to the fact that Asian investment income is relatively modest, in contrast with the situation in Europe which is in first place for total trade in services (credits and debits). Japan exports very few services but imports a great many of them (equivalent to 45 per cent of merchandise imports).

Table 12: The regional structure of Japanese current transactions in 1991. Geographical pattern of trade (see Table 13)

Table 13: The regional structure of EEC current transactions, 1979-1998

By and large, EEC trade in services is less centred on Europe than is its merchandise trade; however, the difference is much less market than for the United States. As in the United States and Japan, most tourism takes place within the Community itself, whereas transport services are supplied essentially outside Europe in the form of intercontinental transport.

Over the period 1979-1988, intra-area trade in services increased quite significantly, but apparently less so than intra-area merchandise trade. This was especially true of freight transport, but it was increasingly provided by non-European companies. Trade in services thus followed the general trend towards regional integration in the period under consideration.

2.3. The changing nature of regional integration and multilateralism

This history of regional integration and multilateralism shows striking similarities, which can be illustrated by retracing the history of the GATT negotiations and the various stages of the construction of Europe.

The Kennedy Round at the start of the 1960s focused on lowering tariff barriers, while the Treaty of Rome advocated that such barriers be abolished between the members of the Community, and that they be harmonised and reduced within the framework of a Common External Tariff; The EEC's programme was completed already of schedule, while its multilateral programme was respected. In this respect, the Community was ahead of the agenda of the various GATT Rounds, which made it possible to achieve more than was demanded at multilateral level.

If regional protectionism were to develop, it would probably take the positive form of additional concessions to neighbouring countries -- a sort of regional preference. Real protectionism, which consists in erecting new barriers to third countries, seems incompatible with the principle of deep integration with neighbouring countries.

Initially restricted to customs tariffs on manufactures, the scope of the successive GATT Rounds was widened to include non-tariff barriers (the Tokyo Round), but without much success, and then to a whole series of new areas: agriculture, services, investment, intellectual property and government procurement[12]. The Single Market antedated the Uruguay Round, since in its essentials it was already in place before 1993 and covers a much wider range of regulations.

In view of these major developments, the very future of the world economic system needs to be seen in a new light. The granting of freedom of establishment in return for reciprocal arrangements or national treatment implies much more than an open trading system. Instead, it indicates that we are moving towards an integrated world or, as some claim, towards globalisation, or "deep integration" as Robert Lawrence calls it.

Deep integration is reflected in the world-wide decline of the public sector, and the opening-up, on an increasingly large scale, of all sectors to international investment. However, major obstacles stand in the way of this general trend.

The first is the lack of a regulated international monetary system, resulting in highly unstable system of exchange rates. This instability, which is caused by inconsistent national monetary policies, has led to some unreasonable currency parities and hence to a rise in protectionism. This is because new forms of protection may seem to be justified, when the conditions of competition seem unfair.

The second is the belief that some types of national behaviour need to be changed. The negotiations between the United States and Japan are exemplary in this respect, as well as being ultimately ineffective. The United States criticises Japan for its thriftiness, while the Japanese criticise the Americans for not saving enough. In the name of liberalism, however, both governments refuse to take the necessary measures to rectify these distortions which pose the more general problem of how the right savings ratio for each country should be defined. This being impossible, the market is left to do the job.

Deep economic integration via the intensification of trade and capital flows is thus faced with two main obstacles: a lack of resolve to organise a multilateral monetary and financial system, and the fact that very different national systems continue to co-exist alongside one another.

---

[12] The Tokyo Round defined the procedures for giving access to public contracts, but failed to specfiy the practical details as to how they would be applied to the sectors concerned.

The European Community's answer to the first question -- that of exchange rate instability -- is on one hand the European Monetary System (EMS), which is a flexible, adjustable system of exchange rates, and on the other a single currency. The EMS fixes the margins within which currencies can fluctuate around a central rate. It functioned during the 1980s but is now experiencing a lot of problems, at the very time when the objective of a single currency is officially embodied in the Maastrich Treaty. The reasons for the current crisis are twofold: first, and primarily, the cost of German unification has put the main economy in the EMS under extraordinary pressure, with a knock-on effect on Germany's partners; second, strict margins of fluctuation were imposed much too soon on countries (the United Kingdom and Spain in particular) which did not yet meet the necessary conditions. The current crisis facing the EMS may seem a temporary phenomenon that will last as long as the process of German unification...

As long as there is no clear sign that a major recovery is under way, it may be considered that the current and anticipated cost of German unification is too high for the financial markets, and that this cost will continue to put pressure on real interest rates in Germany and, by the same token, in the rest of Europe, thereby delaying economic recovery, as well as economic revival in the Eastern European countries.

However, the long-term logic of deep economic integration is financial and monetary integration and stability. If it fails the system will tend permanently to generate various forms of neoprotectionism which will delay economic integration. This is true of the Community of the Twelve. Will it also be true of a Europe that includes the EFTA and Eastern European countries? Will it be true at a world level?

3. TOWARDS THE GLOBALISATION OF THE ECONOMIC SYSTEM

3.1. From internationalisation to globalisation

The concept of globalisation was made fashionable by Japanese economists. It plays two roles, one descriptive, the other ideological.

At the descriptive level, globalisation denotes two different, albeit complementary, phenomena: first, the fact that enterprises are becoming world-wide undertakings; second the fact that different economic activities are merging. Bankers are becoming insurers (and vice versa), manufacturers are becoming distributors, computer firms are supplying both hardware and software, airlines are providing booking and travel services, etc. The borderlines between jobs are becoming blurred. The service provided is the crucial concept and, as such, it is transforming the nature of economic relations and productive structures. Instead of being concentrated around production centres of increasing size, activities are being networked. An unbroken chain of activities extends from the manufacturer to the consumer, comprising production packaging, transport, delivery and on-site service, which permits an overall optimisation of activities. And this is backed up by a chain of financial services, payment systems, insurance and credit services. High transaction costs justify the installation of continuous processing lines.

The concept of globalisation also has an ideological function: it asserts the decline of nations and the State, and establishes the omnipotence of private enterprises, the nationality of which is ceasing to have much importance. Significantly, Japanese economists invented the concept, and have frequent recourse to it in international forum. By arguing that nationality is ceasing to be important, the growing power of Japanese firms can be relativised and, by the same token, their internationalisation can be reduced to a purely private phenomenon. However, it is clear that those Japanese firms that have moved offshore have done so essentially to circumvent the protectionist measures taken by their trading partners; In other words, in many cases it is not so much that they wanted to become global undertakings but that they were obliged to do so because of protectionism. In contrast, it is well-known that the Japanese market is difficult to penetrate and that the number of western firms in Japan is tiny (only 2 per cent of industrial production is foreign-controlled).

3.2. The progress of globalisation

As a result of two developments, the process of globalisation underwent a qualitative change from the 1980s. First, this period saw -- in the shape of the GATT negotiations on international trade and the process of European integration -- the transition from an interdependent world economy to an integrated world economy. Up to 1985, trade liberalisation had meant the liberalisation of trade in industrial products only (and even not all of them); also, governments were still fairly free to conduct economic, monetary and industrial policies as they wanted. The growth of free trade has called radically into question the independence of national economic policies. Major upheavals are taking place: the liberalisation of capital movements between the main developed countries; the opening-up of the service sector to free trade; and the opening-up of public procurement to international competition. With the end of the Cold War, the role of the military-industrial complex, and thus of the State, in development, has tended to decline. At the same time, the State's economic importance has grown with its increased social role -- in education, health and pensions. Increasingly, the role of the State is a domestic one, while that of private enterprises is becoming global.

The second development was that more and more major firms started to adopt global strategies. In the 1960s, US firms had pursued a two-pronged global strategy: first, they set up plants in Europe to secure access to that market; second, they set up production facilities in Asia to take advantage of the low wages and to reexport the output to the developed countries; Subsequently, and especially during the 1980s, European and Japanese firms have adopted global strategies designed primarily to expand their presence in Europe and the United States. Since the creation of the Single European Market was announced, European firms have embarked upon a marked wave of mergers and acquisitions, the main aim of which is to strengthen their presence across Europe. French firms have been building up their presence in Germany, Italy and the United Kingdom, and German and Italian firms have been doing likewise. World economic activity is now tending to be organised in numerous networks of dominant firms that cover the entire planet from three polls: the United States, Europe and Japan. Networks are essential to winning markets, as well as serving to organise overall economic activity. The current growth of networks has been made possible by the revolution in telecommunications and computers. The costs of setting up networks -- especially marketing networks -- are considerable, and are formidable barriers to entry. Japanese international trading companies, air transport booking systems, banking systems and, of course, telecommunications networks, are well-known examples of networked activities that allow their owners to enjoy a quasi-monopoly. Furthermore, such networks are multifunctional. For example, trading companies have several roles: at the centre is the gathering and disseminating of information, the buying and selling of products, financing and insurance, and personnel management.

The image of a world enmeshed in corporate networks which are capable of monitoring world-wide developments round-the-clock and of intervening at any time, no longer altogether belongs to the realms of science fiction. Simultaneously, firms are becoming more and more diversified. A loose conglomerate of powerful networks is the form of corporate organisation best suited to this new situation.

3.3. Quantifying globalisation

A few partial figures give a rough idea of the scale of globalisation. In the United States (Table 14), manufacturing sector imports in 1988 represented 17.4 per cent of national output, or 16.5 per cent of the domestic market: foreign-controlled firms accounted for about 12.7 per cent of US production. This gives an overall rate of foreign penetration of the largest market in the world of nearly 30 per cent. A quick estimate for the rate of penetration of European countries would be about twice as high, or nearly 60 per cent! In sectors such as electronics, globalisation is even more advanced.

Table 14: Globalisation of US manufacturing industry

World rates of globalisation are lower (see Tables 15 and 16). Table 15 gives a breakdown of world production by major geographical area, and of trade between these areas. The ratio of production to trade allows the degree of interdependence to be calculated: world output total US$ 9 852 billion, and trade amounts to US$ 2 189 billion, or 22.3 per cent of world output. If the activity of multinationals outside their country of origin is also taken into account, foreign-controlled production amounts to US$ 1 627 billion, or 16.5 per cent of total world production. This gives, all told, a world-wide average rate of globalisation of 38.8 per cent.

Table 15: Destination of world output by market

Table 16: Breakdown of output by national origin of controlling firm

At first sight, it might be thought that globalisation is much less advanced in the service sector, and this for two main reasons: first, the sector was deregulated only recently, and then only partially; second, by their very nature, there is little trade in services. However, globalisation is already very advanced in some specific sectors (for example, finance, air transport) as a result of the internationalisation of capital[13].

3.4. Quantifying financial globalisation

[13]See "Assurances: l'Europe au coeur de la mutation", P. André, in "Economie mondiale: de Berlin à Bagdad, Economica, 1991.

The initiative to liberalise capital movements and to float currencies was taken by the United States with a view to making the world economic system more flexible. The idea was to break free of the current balance equilibrium constraint. However, the oil shocks, the third-world financial crisis, the stock market crashes and currency fluctuations showed that, although the system had become more flexible, it had not become more stable.

The contradictions that result from the existence of several international currencies, and monetary politics with deferring national aims, are growing. Sometimes, they result in substantial differences in real interest rates between the three poles of the world economy.

In any case, it is clear that financial interdependence has increased. If, for example, it is measured on the basis of net capital flows (credits), it may be seen that their share in international transactions has doubled in 20 years, from 10 to 20 per cent, with the most rapid increase taking place during the latter part of the 1980s. Furthermore, if we add in debt-service transactions, which are included in investment income flows, the figures rise to 15 and 31 per cent respectively (Table3).

4. DIFFERENT WAYS TO GLOBALISATION

Foreign Direct Investment is a good tool to use if one wants to understand the reasons of globalisation. It might sound a little bit paradoxical to hear that the American way is not the Japanese way, because globalisation is often use to deny any further national differences. In a globalised world, there still are American, Japanese, German, French and Chinese firms with specific patterns of behaviour. To understand this point, it may be useful to compare American FDI and Japanese FDI. In the last part, we will give a short descriptions of the NIC's strategy both as a recipient of FDI, and more recently as an active exporter of FDI.

4.1. US FDI in perspective

Before the Sixties, FDI in manufacturing was an exception. FDI was overly directed to the development of new raw material sources. Crude petroleum, copper, gold, diamonds or tropical agro-products were among the most important targets of international investment. The MNC's operating in these industries were to some extent a symbol of a colonial division of labour. Developed countries were exporting manufactured products and capital to colonised countries (some of these were very rich like Australia or Canada) in exchange of raw materials.

With the end of colonial empires and the liberalisation of international economic relations, a new phenomenon appeared : more and more manufacturing firms started to become truly multinational firms. Developing countries started to manufacture low technology products and more and more countries started a successfully industrialisation. American firms were among the first to develop this new strategy on a large scale. And Asian countries were the first to choose industrialisation through export promotion policies.

US firms initiated large FDI in manufacturing industry in the early Sixties both towards Europe and the developing countries. In Europe, investments made by US firms were a way to gain access to a rich, large and fast growing market, well suited to American goods. It was also a way to escape any protectionist threat which could have emerged as an undesirade by-product of the creation of the Common Market. The strength on which American firms base their advantage was their technological edge over European firms.

In the developing countries of Asia, US firms looked for low labour costs for their labour intensive industries. Competition was driven by Japanese textile firms in the US market, which put American firms in danger. Factories were closed in the US and opened in developing countries. But, access to local markets was not a part of their strategy.

In the Eighties due to balance of payments difficulties and an overvalued US dollars, US firms did not modify their behaviour but they reduced the flow of outward FDI. On the contrary, the US itself became a major target of Japanese and European firms for inward FDI.

The US technological edge over other OECD countries has been reduced. The growing cost and diversity of innovation has made it impossible to maintain an autonomous technological development. As a consequence, US firms are looking more and more to strategic alliances. Even IBM and Boeing, by far the world's leaders in R&D investment, have started to participate actively in this movement. Thus American firms, as well as European or Japanese firms have to learn about different ways of doing business, as such big companies more or less loose their national bases.

4.2. Japanese FDI in perspective

The Japanese firms are latecomers in outward FDI. Before 1968, they were not allowed to invest outside Japan -except in commercial support for exporting activities- because of World War II. Starting in 1973 a new strategy emerged which was guided by security concerns. Being almost deprived of all natural resources, Japan has to secure stable and continuous sources of raw materials. Guided by the Japanese government, Japanese firms invested in the Pacific basin with the clear aim of diversifying and securing their sources of raw materials between Canada, Australia, Indonesia and other nations from the Pacific Basin, as well as Brazil (which was strangely classified as a member of the Pacific Region in many Japanese papers).

At the end of the Seventies, Japanese firms, threatened by American protectionism entered a new phase of internationalisation. They began to invest in the manufacturing industry where they possessed a very large competitive edge, mostly in consumer electronics and in automotive industries. In the Eighties, due to their large external surplus and to mounting protectionist pressures (and through financial deregulation), the Japanese government started to encourage FDI in the US, in particular in the automotive industry. Access to the US market was the major motive of Japanese investment. Later Japanese firms started to invest in Europe especially by investing in Great Britain. From 1980 to 1986, FDI averaged about 3% of merchandise exports, but from 1987 to 1992 it averaged 12%, after peaking at 17% (in 1990) and declining to 11% in 1992.

Taking advantage of deregulation of service industries in the US and Europe, the third phase (after 1986) of Japanese investment was characterised mainly by the development of FDI in service activities (Table 17). The finance, trade and real estate sectors (in developed countries) were the most important recipients of Japanese FDI. Japan along with Germany, up to the German reunification, was the most important source of net international financial flows, and became a major financial player in the global economy.

Table 17: Japanese FDI by sectors

With low financial constraints, Japanese firms could invest where they wanted. But contrary to the US strategy, we will show that Japanese investment aims more at consolidating base in Japan and protecting its market share in developed countries, rather than building factories outside Japan. In particular, the search for low cost locations is not a priority.

Nevertheless, given the rapid rise of labour costs in Japan and the rise of yen, one would have guessed an urgent need for Japan to look for low cost locations. If this were so, Asia would have become a privileged destination of Japanese FDI. There are at least five major reasons for this.

1. Differences in labour cost between Japan and developing Asia are enormous at current exchange rates.

2. The quality of the blue collar worker is rather high in East Asia (compared to other developing areas).

3. The cultural distance is less between Japanese people and Chinese people than with western, African or Latin America people, the geographical distance is also less, which reduces the cost of operating overseas.

4. The domestic markets in most East Asian countries are growing very quickly.

5. And often there are better economic regulations in Asian partners (NIC's) than in other parts of the world.

What were the results?

Looking at the geographical breakdown of Japanese FDI (Table 18), we can see that North America takes the biggest share, almost 50%. This share has increased very rapidly from a meager 16% in 1974. In contrast, the share of the developing countries and Oceania (primary product exporters) has declined very rapidly from around 80 % to less than 35%. The causes for this are numerous: first the debt crisis of the Latin American countries and of many developing countries was a major cause; second the decline of primary product prices reduced the resources of these countries; third is attractiveness of developed country markets compared to developing markets.

But it was only when protectionist measures were taken by the US and Europe that Japanese firms managed to invest in these regions.

Table 18: Japanese manufacturing FDI: Geographical break down

The sectoral breakdown of Japanese FDI (cf. Table 3) and its transformation over a long time period, also reflects exactly the relative strengths or competitive advantages of Japanese industries.

Up to 1974, textiles were leading in FDI (22%), while in 1991 electronic industry was leading (24%). If Japanese firms were looking for low cost locations, we should have expected a rise in textile investment. On the contrary, the textile share of FDI declined from 22% to only 5%. The relative decline of the Japanese textile industry took place in the mid-Sixties, the decline in FDI probably ten years later.

As expected the share of Asia in textile FDI was dominant at 65% before the first oil shock, but it declined to 45,8%, which is equivalent to the size of Japanese textile investment in Europe and America which are hardly low cost location.

The textile case shows clearly two dominant characteristics of Japanese FDI : as Japanese competitiveness declined in textiles, so its share declined in FDI. FDI did not compensate for the decline of the textile industry. As a consequence, low labour costs are not a dominant cause of Japanese FDI.

If we look at the electric-electronics industry, wee can see that its share in FDI rase from 10% to 24%. In the meantime, the share of Asia in this sector declined from 50% to 22%. In the early Seventies, Japanese electronics industry was a rather low technology producer. For that reason it had to retain some of its competitive edge through investment in other Asian countries. In the Eighties, as Japan's technological level increased dramatically in the electronics industry, so the share of electronics in FDI increased, but during the same period the share of FOI in Asia decreased. As labour cost became less important in electronics industry competition, so the share of the Asian developing countries was reduced.

Table 19: Japanese FDI in manufacturing industries

Contrary to American firms which were investing in Asia and exporting most of their production back to the US, Japanese firms are also exporting to the US, from their affiliates based in Asia.

Affiliates of Japanese firms in Asia were exporting only 17% of their sales to Japan, 24% to the rest of the world, and 59% to the local economy (the relative shares for Latin America were 4%, 15% and 80% to the local economy).

In the textile industry, only 5% of Japanese import were from Japanese affiliates. By contrast, in the electronic industry 100% of imports are from Japanese affiliate sources. In the case of textiles, Japan is clearly loosing control of the industry. As there are relatively few innovations in the textile industry (at least in the garment and in the knitting industry), the possibilities of maintaining factories in the developed countries are rather narrow. More important, opportunities to relocate in developed countries (in case of automatisation) are very limited exceptions. It is only in the synthetic yarn industries that developed countries retain an important advantage because these activities are highly automatisized and highly capital-intensive activities. A large part of the garment and knitting industry is going to developing countries, that is to say to countries with low labour costs. There seems to be no alternative to this trend.

By contrast, electronics is an industry with intensive innovations. It is to a large extent a highly capitalistic and R&D intensive activity. As a consequence, there are always possibilities for developed countries to maintain their advantage over developing countries. And it is also clear that new sophisticated electronic products can only be on sale in highly advanced countries, at least during the first stage of the product cycle. Thus production facilities and markets are closely linked to one another.

4.3. NIC's investment in Asia

In the late Eighties, there was a sudden and quite large flow of FDI emanating from the first generation of NIC's towards the second generation of NIC's (Thailand, Malaysia, Indonesia and China). The flow was so important that the share from NIC's was often higher than the share of Japanese investment. In Malaysia, Asian NIC's FDI amounted for 47% in 1991, 20% compared to from Japan, and 11% from the US. In Thailand, the numbers were 32% for the NIC's, 35% for Japan, and 23% for US. In Indonesia 23% for the NIC's, 11% for Japan and 3% for the US. In China most FDI is carried out by overseas Chinese (Table 20).

Table 20: Foreign direct investment by american, japanese and NIES firms in ASEAN countries

The reasons are fairly clear:

. First, there is s general shortage of manpower in the NIC's.

. Second, labour costs have risen quickly in the NIC's.

. Third their currencies (for Taiwan and Singapore at least) appreciated against the US dollar.

Last, these two countries registered large financial surplus. These factors made investment in countries with low labour cost advantageous.

The question now is whether these investments have a positive effect on the host countries. In the past, there has been a hot debate on these matters.

Looking briefly at different experiences, it seems that there are no general rules. Singapore has a very narrow indigenous manufacturing industry, with 72% if its value -added made by MNC's (Table 21). By comparison, only 10% of Korean value- added is made by MNC's. Which of the two is the most successful country? It is hard to say. It is also clear that Chinese Taipei has a very low MNC manufacturing base (less than 10% of employers are working within MIN's, et, Taipei is also a success story. Korea and Taiwan both have a strong bureaucracy to control MNC activities).

Table 21: Significance of the activities of transnational corporations to the host economy, selected years

For most (Thailand is the exception) Asian countries, the share of MNC's in exports is by far larger than their share in value -added and employment. In the case of developed countries, this is generally not the case (in France, MNC producers are only slightly more export- oriented than French firms). From this it is clear that MNCs are present in Asia to benefit from low labour cash. In fact, it is often a condition by host countries to impose a high export target for MNC's. Export processing zones are often completely separated from the rest of the country.

In such cases, MNC's play a major role as exporters. That is why Japanese firms are often reluctant to invest in Southeast Asia.

Is there a real danger of dependency? If one looks at the Korean or Taiwanese experience it seems that it is only a necessary step before taking full responsibility (if necessary) for exports. In effect, it is certain that there is a fairly large cost of entry into international trade. It is necessary to invest in order to create a network of customers and to manage complex transactions with foreigners. As a first step, MNC trading companies can be of help to strengthen the industrial base. It was only in the Eighties, that Korean firms started to try to sell their products under their own brand names . Nowadays it seems that 50% of Samsung products are still on sale under other (American or European) brand names. Similarly, very few Taiwanese firms -except ACER- have gained any significant reputation in Western Europe. However in some cases Taiwanese firms working under OEM agreements became so successful that they were able to buy back their distributors in the US.

As can be seen from these two examples is that here is no insurmountable dependency position.