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essential that the determination of some key magnitudes should be left out of the field of international competition (interest rates and exchange rates, for instance). There should be no more interdependency in the system than we are collectively able and willing to handle. Otherwise, a lot of energy will be wasted trying

to “muddle through” the difficulties caused by excessive instability.

Trying to prevent those two systemic risks – marginalization and macroeconomic instability – is precisely what the purpose of international cooperation should be.

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Wolfgang Hager\*

### Protectionism: a World Divided?

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**G**rowing protectionist practices and tougher legislation in the USA and the European Community have led some observers to fear a break-up of the world economy into three parts: Western Europe, East Asia and North America.

In fact, the opposite is true: the growing integration of the world economy – which is the dominant trend – brings with it, at the margin, minor quantity and price “corrections”. If one takes into account the heterogeneity of the economic systems trading with each other and the instability of price and supply patterns caused by exchange rates, technology and dynamic newcomers, these corrections are indeed surprisingly small. One reason is that prices in final markets are much less disruptive than supplier costs: traders serving as intermediaries and local producers assimilating “off-shore” inputs in their product range act as buffers by respecting high local price levels. They prefer to take economic rents over market shares.

Leaving agriculture and textiles aside, current protectionism is heavily concentrated in two sectors: automobiles and electronics. These sectors are dominated by very large and multinational companies. So why do these global actors not adopt a global, free-market approach? Why are American-owned companies such as Motorola, UK, or Ford, Germany, among the most outspoken proponents of “fair trade” practices by the European Community? Why do Siemens and Philips, whose global strategies are wholly dependent on large volumes of trade, argue for a European “industrial policy”?

To understand the global games being played, it is useful to lump together goods and services trade on the one hand and direct investment on the other and ask

what exactly is “sold” abroad by either means. The answer must be that values from three sources are traded: labour, management, and a joint product of both, technology. Protectionism occurs if the price/performance ratio of exported output from any of those sources seriously disturbs the local status quo. In technology, that disturbance may be immediate – new generations rendering old ones obsolete – or anticipated as a future risk of marginalisation of companies or countries.

Protectionism takes two forms: trade restraints and, increasingly, local content and technology conditionality for both trade and investment access. Reduced to its essential, it is one device of several used by large companies to assure a modicum of oligopoly discipline disturbed by the textbook causes of too many suppliers and significant cost differentials – themselves the consequence of the globalization of the world economy.

Governments are not the primary actors but are instrumentalized by companies. This is often assumed to mean that they act for the particular and against the general interest. Yet going against the stern advice of economists, their political instincts are often right: this (limited) restraint of competition probably does more good than harm, as it facilitates rational planning of resources, encouraging investment in real and human capital, and R&D in large corporations (Galbraith) and, given their role as huge buyers of goods and services and as taxpayers, in the economy as a whole.

#### Likelihood of a Break-up

It is against these obiter dicta that we can now examine the likelihood of a break-up of the world economy. The formation of a North American free trade area creates, no doubt, a potentially autarchic economic space. But an industrial culture strongly oriented towards short-term cost minimization has made off-

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shore production, and hence the labour markets of Mexico and East Asia, a structural part of the US economy. That same short-term thinking has misled US firms to subject what should be sustained R&D in key industries to the vagaries of market cycles. A growing dependence on external technology, and an off-setting capacity at technology export, created a second, solid tie between the US economy and the world.

Off-shore production put (some) US labour in direct competition with LDC labour. An absolute decline of blue-collar and clerical wages in a period of rapid growth was the result. Any company wishing to do so can use political resistance to this state of affairs to form coalitions with labour in favour of protectionism. For the rest, the growing dualism of the American economy is ignored: the majority consumer interest wins out.

In addition to the competition between Asian and US workers there is competition between US and Asian managers – in this case Japanese. Using direct investment to exercise their competitive strengths, these managers can often use US (and European) resources better than the natives. This is competition as it should be – between firms rather than socio-economic systems – although adjustment costs still do not fall on the losers – managers with golden parachutes – but on the socially weak.

While the exploitation of absolute advantages in management in the production of routine goods is best done via direct investment, in high technology trade is often irreplaceable. Direct investment leaves most non-management related value-added activities in the host country: labour, semi-finished goods and components, energy, and external services such as transport. It is thus less disruptive than imports. The production of high-technology goods, however, involves the whole production process including local components and capital goods suppliers, specially trained labour, etc.

American protectionism seeks to satisfy interests which are so conflicting that it must remain limited. Trade restraints on mature goods such as automobiles serve to maximize local content explicitly or otherwise and hence lead to direct investment. If this is done via a greenfield plant, this may mean overcapacity and a need to write off plant, infrastructure and human capital elsewhere in the local economy. If an existing plant is taken over, the disturbance is limited to price/quality competition reflecting superior management. In time, natives and conqueror intermarry, i.e. they enter into crossed share-holdings and joint ventures. Oligopoly peace is re-established. In previous decades, the same effect could be achieved by multinationals threatened by newcomers establishing counter investments in the

attacker's national home market. If one assumes, with Galbraith, that oligopoly is the efficient form of industrial structure in mature industries, protectionism in these cases is merely the means to an inevitable end (with annihilation as the only stable alternative).

Restraints in high-tech areas can still be thought of as serving infant industry protection. The difference to earlier periods is the greatly compressed time-frame – as little as six months – within which a head-start in the market can create, through economies of scale and standards-setting power, what one may call dynamic barriers to entry. Since in the case of semiconductors, domestic user industries would be penalized by trade protection, the most efficient form is financial protection of the kind practised in Europe's national and cooperative R&D programmes. The US version of subsidy policies, largely limited to the military market, is ill-suited to the fast games played in today's civilian markets. Bilateral cartelization via the US-Japanese semiconductor pact is an attempt to moderate price competition somewhat and to create the conditions for a more lasting peace through joint ventures, technology licensing, etc. The threat of protectionism, again, is a merely tactical (but necessary) ingredient for achieving tolerable competition levels.

It is as much a sign of confidence as weakness that the European Commission is planning to slap heavy local content conditions on US and Japanese chip makers – confidence that such a move would not damage the European IT industries depending on cheap supplies of chips. Far from heralding a break-up of the world economy, the move intends to regulate only the terms on which Europe "buys" the fruits of US and Japanese technology and production know-how: through domestic plants which, in addition to the value-added implications, would presumably be more reliable suppliers to EEC industry than arms-length exporters have proven to be.

Such trade moves are part of an overall strategy aimed at influencing the development of the key electronics industry – a strategy controlled by bureaucrats, but developed in an extensive and sophisticated dialogue with supplier and user industries. Another part of this strategy is to re-create, at the European level, the kind of technology-promoting public markets which no longer work nationally: RACE, the programme to devise a jointly specified broadband telecom network and the coordination of national infrastructure investment plans; HDTV, fiercely defended in international fora and designed to create a massive market for advanced chips; Prometheus/DRIVE, the intelligent car of the late 1990s, relying on

huge public infrastructure (a word that today means systems software as much as hardware).

Another key part of "trade" strategy in this broad context is the development of standards in IT industries, which have proven a powerful global market tool. The EEC's efforts – undertaken via ESPRIT, RACE, etc. – are formally designed to create open, international standards. The alternatives are, as often as not, proprietary standards promoted by huge Japanese and US corporations. But since all the European IT companies together amount to one IBM, the European strategy becomes much clearer if one thinks of it as the development of proprietary standards for "Euro Inc."

The second thing to keep firmly in mind is that such regional, company-driven strategies are always global strategies: partial world market segmentation is merely the basis for equitable deals with competitors on anything from technology to market access itself. Understanding protectionism in sectors such as automobiles and electronics as heralding a break-up of the world economy is to apply atavistic memories of the thirties to a totally different reality.

### Fortress Europe

European company chairmen arguing for protection do not, of course, explain their actions in terms of oligopolistic stability. Rather, they argue that one cannot have a high-cost, socially responsible economy in Europe while its beneficiaries, as consumers, use their wages to buy low-cost imports from abroad. In the most protectionist industry, electronics, that claim rings hollow: all European companies source heavily in low-wage Asia. It is the failure of management – from R&D to marketing strategies – which has provided the opening for the Asian dominance in photocopiers, faxes, videos, etc.

In the automobile sector, too, given universally robotized production lines tended in every country (except Korea) by high-wage workers, it is now management rather than Europe's social quality which is the main culprit for competitive difficulties.

However, management does have some political excuses. Not only has there been union-imposed overmanning, not least in Germany (VW), cutting profits and investments; in addition, structural adjustment of overcapacity has been hindered by the presence of six equal volume producers (FIAT, VW, PSA, Ford, GM, Renault), each with a 10-14 % markets share – too little to produce efficiently and too even to have allowed take-overs.

"Punishing" management by imposing pure free trade after 1992 (when present national quotas run out)

may satisfy ideologues; however, the bill would be paid by the European economy, for which the auto industry is a vital buyer of everything from steel to capital goods to software and electronic components. Imposing local content conditions on Japanese direct investment is a sensible precaution against a strategy based on the deliberate creation of overcapacity which slowly strangles the competition.

### Towards a European Mixed Economy?

So far we have argued that much of what passes for divisive protectionism is simply the result of competitive games played by basically cooperative global companies. The essential novelty of the 1992 agenda does not, however, lie in the abolition of internal trade barriers, which transfers such issues increasingly to the European level. The essence of the 1992 agenda lies in attacking remaining bastions of State power in the economy. It is these areas of regulation and/or intervention which have resisted forty years of post-war liberalization: procurement and associated R&D policies; health and related standards; services regulation; regulation of professions; and company law, with its "constitutional" and fiscal aspects.

This agenda has a number of interesting implications, one of which is that it forces Europe again and again to pass from a merely technical debate on "harmonization" to a truly political debate about the nature of its economic systems, priorities in such areas

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as ecology and, ultimately, the good and just society ("social dimension", etc.). More important for the purposes of this paper is the perceived discrimination against outsiders, rendered more visible by a similar GATT agenda.

The first thing to note is that Europe's road to greater internal liberalization must largely be via deregulation, period. Anything else would be too complicated. This means a net reduction of state intervention and regulation, with *erga omnes* benefits.

There remains, however, a crucial residual level of European regulation – whether in telecom, banking, insurance, or other areas – and an equally crucial residual of what one tends to call industrial policy: procurement and industrial targeting. While there is no doubt that the Community lacks adequate political and social institutions to decide on these issues (it does so anyway), there is also no doubt that it has the political institutions to enforce such residual regulation as remains. Competition law is one of the broadest and most crucial instruments to ensure a fair and level playing field (subsidies!), a device without which national "disarmament" in matters of industrial policy would be too risky.

It is enough to compare the Community institutions, with the direct executive powers of the Commission and

the legal clout of the Court of Justice, with the codes and arbitration panels of the GATT to realize that the West-West liberalization agenda must be of a different, much more modest, quality. However, GATT and OECD codes, signed by Member States in a past when they had a host of regulations and devices to frustrate any far-reaching application, throw the Community (much weaker) regulatory space open to all non-EEC partners. Reciprocity is a notion of doubtful validity in terms of the post-war international economic order: reciprocity of opportunity, not results, is clearly the intended sense. That does not make its use by the Community less necessary. A true *erga omnes* liberalization would simply not be acceptable to key Member States (including, in services, Germany) and would hence prevent the completion of the 1992 agenda.

Again, to take up the point of the introduction, the overwhelming *economic* reality is also one of a growing *global* interpenetration of the services markets, growing business cooperation, and cooperative procurement projects. The common objective of "protectionism", whether promoted by corporations or political authorities, is to create instruments for equitable bargains. For such a device to be superfluous, we would have to live in a textbook world of atomistic markets, not one of strategies for which the existence of a single world economy remains axiomatic.

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Georg Koopmann\*

## Reorganization or Disorganization of the World Economy?

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**A**t the moment, the world economy looks healthy. The growth forecasts for the past year, made in the wake of Black Monday in October 1987, were eclipsed by the actual rates while inflation remained under control. For the current year too, a high rate of growth and relative price stability are predicted with growth in the developing countries expected to overtake that of the industrialized ones. The debt crisis in the Third World seems to be abating; export revenues are now rising faster than aggregate debt. The American

trade deficit is gradually receding, though progress is sluggish and the resurgent surpluses in the Federal Republic of Germany and, in particular, Japan are posing a new threat. At the same time, the integration of the world economy is advancing: world trade is expanding fast, faster than world output and the increase in direct investment abroad is exceeding domestic capital formation rates.

In its latest World Economic Outlook, the International Monetary Fund partly ascribes these unexpectedly favourable developments to the economic policy coordination and collaboration of the major Western

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