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Paul J. J. Welfens\*

# The Globalization of Markets and Regional Integration

*The 1980s have witnessed the globalization of markets and an intensified international competition. The rise of the newly industrializing countries and the growth of multinational enterprises – developing parallelly to foreign direct investments – have contributed considerably to this trend. However, there are factors suggesting that the intensification of market competition might be only a transitory phenomenon.*

Following the persistent internationalization of economic relations during the 1960s and 1970s – which was chiefly confined to the OECD countries and took the form of growing trade flows and a profounder international division of labour – a new phenomenon arose in the 1980s. By pursuing outwardly oriented policies on development, trade and industry, the newly industrializing countries (NICs) have contributed to an intensification of competitive processes around the world: quite apart from their traditionally important role on the demand side, they now occupy an ever more significant position as suppliers on the world markets, a clear reflection of how quickly these countries have caught up in technological terms. By the mid-1980s, the NICs' share of the supply of manufactured products in the USA had reached almost 2.5 %, with much higher values being recorded among the OECD countries in specific fields. Japan, whose comparatively limited imports relative to its domestic value creation reflect the export impediments of which foreign suppliers complain, stands alone in showing a very low and barely increasing rate of import penetration from the NICs.<sup>1</sup> Thus, as in Japan's case, there are gaps in the intensification of worldwide competitive processes; other regions which have been only indirectly affected by intensifying supply competition in the past but which are now gradually opening to world trade are Eastern Europe and a host of developing countries.<sup>2</sup>

Yet at the same time the question arises as to whether the globalization of world markets is really any more than a temporary intensification of competition. The question is prompted by considerations such as:

- the increased merger and acquisition activity in the USA during the 1980s;
- the increasingly significant phenomenon of new forms of non-equity corporate cooperation (e.g. cross-licensing, joint ventures) which are also gradually beginning to include multinational corporations from the NICs;
- the creation of the EC's internal market by 1992 and the keenness, prompted by technological factors, to carry out amalgamations among European companies, many of which in turn have capital ties with US or, less frequently, Japanese corporations.

A reflection of international interdependence in terms of ownership participation is provided by the flow of direct foreign investment, but the new forms of cooperation are difficult to show statistically; nevertheless, the fact that 85 % of international trade in technology is concentrated among companies from just 10 market-economy, industrial countries – and that these are all among the top 15 countries for direct investment – suggests that direct investment and technology trade operate substantially in parallel.<sup>3</sup>

<sup>1</sup> To this must be added the observation that Japan has a very low level of intra-industry trade compared with other OECD countries, although this is now slowly beginning to grow; cf. R. Z. Lawrence: Imports in Japan: Closed Markets or Minds?, Brookings Papers on Economic Activity, 1987, pp. 517-548.

<sup>2</sup> The stagnation in the growth of per capita income in the CMEA countries since 1975 and the fact that they have fallen behind the NICs on a relative basis as the latter rapidly gained ground both in terms of technology and of average incomes can be presumed to be a major factor in the reform process which has been underway in the CMEA countries since 1985; cf. P. J. J. Welfens: Growth, Innovation and International Competitiveness, in: INTERECONOMICS, Vol. 22, No. 4, 1987, pp. 168-174; K. Z. Poznanski: Technology, Competition & the Soviet Bloc in the World Market, Berkeley (Institute of International Studies) 1987; D. Cassel: Wirtschaftssysteme im Umbruch, München 1989.

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On the strength of greater involvement through direct investment, there is also a growing interdependence of industry among the leading industrial nations, although here too there are substantial instances of asymmetry. Within the triangle of the USA, Japan and the EC, Japan is indeed an important source country for direct investment, reflecting its balance-of-payments surpluses during the 1970s and 1980s: the relative growth in Japan's contribution to direct foreign investment becomes clear from the increase in its share of the global total which rose from 0.7 % in 1960 to 6.6 % in 1980 and 11.7 % in 1985. Yet, whereas Japanese outward investment in the USA and EC countries plays an important part, direct investment flows in the opposite direction remain relatively limited; its 1 % share of the global total for inward direct investment in 1985 is disproportionately low when set against Japan's share of world GNP; the corresponding shares for Western Europe and the USA were approximately 29 %.<sup>4</sup>

The process of dismantling overt restrictions on direct investment in Japan which began in 1979 (the Foreign Exchange and Foreign Trade Control Law as amended by law No. 65, 1979) has so far only produced a negligible expansion in such investment; the source of the problem lies in take-over difficulties peculiar to Japan, in widespread staff recruiting problems for newly established operations due to the principle of lifetime service which prevails in major Japanese companies, and in the real appreciation of the yen since 1984.<sup>5</sup> The rapid growth in foreign direct investment out of Japan is generating an increase in the ratio of production manufactured abroad (by Japanese companies) to the country's domestic production: this ratio was 3.1 % in 1986 and is expected to rise to 12 % by 1993; in 1992 the number of automobiles made by Japanese subsidiary companies in the USA is expected to be 2.2 million, just under the 2.3 million upper limit set by the "gentlemen's agreement" on Japanese car exports to the US (1987 exports totalled 1.7 million units). In the reverse direction, the turnover of US manufacturing industry in Japan was about 1.8 times higher than the value of US exports to Japan, though the latter are low compared to those to other markets.<sup>6</sup>

<sup>3</sup> Cf. Deutsche Bundesbank: Patent- und Lizenzverkehr mit dem Ausland sowie sonstiger Austausch von technischem Wissen durch Dienstleistungen in den Jahren 1986 und 1987, in: Monatsberichte der Deutschen Bundesbank (Bundesbank Monthly Report), No. 40 (May 1988), pp. 39-69.

<sup>4</sup> Cf. UNCTC: Transnational Corporations and World Development, New York 1988, pp. 24 f.

<sup>5</sup> Cf. N. Kobayashi: Japanese Intervention with Respect to Direct Foreign Investment, in: Direct Foreign Investment, New York 1987, pp. 95-107; D. I. Okimoto: Outsider Trading: Coping with Japanese Industrial Organization, in: K. B. Pyle (ed.): The Trade Crisis. How Will Japan Respond?, Seattle (Society for Japanese Studies) 1987, pp. 85-116.

### Intensification of World Market Competition

The interlocking capital and trade ties between Japan and the USA clearly indicate the intensified internationalization (both direct and indirect) of the two economies. This has also been accompanied by intensification of the processes of competition; as far as dynamic competitive functions are concerned the Japanese incursions into US markets must undoubtedly be viewed in a positive light. Reservations appear more justified, though, on the competition policy aspects of the NUMMI joint-venture project between General Motors and Toyota to produce vehicles in the USA granted approval in 1984 with limited conditions imposed by the FTC;<sup>7</sup> this applies all the more in that the US vehicle manufacturing industry already has shareholdings in competing companies from Japan. The joint production of a pick-up vehicle by Volkswagen and Toyota which began in West Germany during 1989 is analogous to the NUMMI project, reflecting Western Europe's involvement in resource cooperation and supply-side links between leading automobile manufacturing countries.

In the 1990s, such technologically determined incentives to cooperate or merge will be added to by other tendencies towards the formation of oligopolies in world markets induced by integration policy; depending on how many suppliers are present and on the level of product differentiation (in which innovation plays a major part), the danger is that despite a short-term intensification of global competitive processes, in the long term restrictive practices may gain the upper hand in many industries within the world economy. Because of its static and dynamic economies of scale, the automobile industry is particularly susceptible to latent tendencies towards concentration. Only the South-East Asian NICs – particularly South Korea (using production facilities in North America) – will produce any new suppliers to the world market during the 1990s. Technological factors, particularly the substantially lower limit for an optimum operating unit size relative to the level of domestic demand, again produce an incentive to cooperate or merge operations. In the EC and EFTA countries, cross-border cooperation between different manufacturers has so far predominated over the tendency towards corporate mergers.

<sup>6</sup> Figures taken from UNIDO: Industry and Development. Global Report 1988/89, Vienna 1988, p. 19.

<sup>7</sup> The chief motive for the NUMMI project from the US point of view was to learn Japan's more efficient production methods for small cars and to attempt to improve quality control and productivity by testing different ways of "Japanizing" the organization of production; on this, see J. Langenfeld, D. Scheffman: Innovation and U.S. Competition Policy, in: Außenwirtschaft, 43 (1988), pp. 45-95.

Whether it follows the EC's path of eliminating non-tariff barriers to allow suppliers from both inside and outside the region to actively participate in a uniform, extended market, or removes tariff barriers like the free trade agreement between the USA and Canada effective as of 1989, regional economic integration does intensify competition during the transition phase;<sup>8</sup> it is nevertheless questionable whether competition to keep down prices or to spur innovation can be keener once the readjusted patterns of regional specialization have developed. This problem is much more acute in the EC countries, which have suffered high rates of unemployment since 1982, than in North America where protectionist pressure has eased since the restoration of full employment in the USA at the end of President Reagan's second term<sup>9</sup> and the achievement of a significant reduction in the rate of unemployment in Canada.

### EC Integration and Concentration Processes

When FIAT SpA, after fighting off a rival bid from Ford, took over Alfa Romeo in 1986 hardly a moment after the decision to create the single market in the EC had been taken, this was the first clear sign of a trend towards concentration in Western European industry which can be expected to continue up to the mid-1990s. In part, the creation of the single market serves simply to accelerate an already existing trend; however, there are many cases in which it acts as a catalyst in its own right for further concentration. Indirectly, integration in the EC could also stimulate the forging of alliances between US and Japanese companies, these being the result of voluntary export restraint agreements pledged by the Japanese to individual EC countries. Within the triangular relationships between the economic powers,

Japanese corporations are able to circumvent existing bilateral self-restraint agreements by making direct investments in the USA or the EC (where the preferred sites have so far been in Great Britain, West Germany and France), provided they meet certain minimum local-content requirements; the US-Canadian free trade agreement has expanded the "map of the USA" as an option for industrial settlement which is attractive for Japanese companies at least as long as no new tariff or non-tariff barriers impede trade between the USA and the EC. Thus US-Japanese corporate alliances on North American soil, based either on capital ties or supply relationships, appear to provide an effective option for Japan, allowing it to act as a free rider in trade-policy terms and keep open its access to EC markets. The USA is Japan's most important trading partner, but also the largest customer of and supplier to the EC; US exports to the EC in 1987 had a value of approximately ECU 60 billion (Japan: ECU 35 billion), and its imports from the EC were ECU 72 billion, about five times the level of EC exports to Japan.

Especially in oligopolistic world markets which create a reactive interdependence between companies, the increase in international competitive pressure and the growing specialization which can be expected among North American manufacturers – accompanied by a corresponding growth in their size – also create significant impetus for corporate cooperation and for mergers and acquisitions in Western Europe. However, technologically determined opportunities for cost reductions are also leading to situations in many branches of industry in which a very small number of suppliers are able to cater for the entire production of a country or, looked at from the other side, cover all demand from that country (Table 1).

**Table 1**  
**Minimum Optimal Operating Unit Size in**  
**Selected Production Spheres**  
(expressed as percentage of domestic production)<sup>1</sup>

	UK	FRG	EC
Automobiles	200	8–13	20
Trucks	104	200	21
Agric. tractors	98	100	19
Refrigerators/freezers	85	57	11
Steel	72	33	10
Telephone exchanges	50	14	10
Televisions	40	28–47	6
Microchips <sup>2</sup>	–	30–40	10–20

<sup>1</sup> Shows the percentage ratio between the operationally optimal production volume and total domestic production; figures for the UK are expressed relative to British (and EC) production volumes.

<sup>2</sup> Own research.

Sources: RWI: Konsequenzen der Vervollendung des EG-Binnenmarktes für die wirtschaftliche Entwicklung Nordrhein-Westfalens, Essen, Nov. 1988, p. 50; figures calculated on the basis of the Cecchini Report and data from DIW: Empirische Untersuchung von industriellen Größenvorteilen (Economies of Scale) nach der Methode der Ingenieurschätzungen. Report to the Monopolkommission, Berlin 1985, p. 341.

Under these circumstances, the immediately most important alternative strategies for intensifying competition are increasing import competition or regional economic integration; if the optimal production levels are measured against the market of the EC rather than that of West Germany, the indicator values in Table 1 show a marked decline. Larger marketing and production areas thus contribute to the intensification of

<sup>8</sup> There is considerable asymmetry between the trade policies of the USA and Canada, as is bound to be the case given the relative size of their economies; 18.9 % of US foreign trade was conducted with Canada in 1986, whereas 71.1 % of Canada's foreign trade was conducted with the USA; on this and on the debate surrounding the US-Canadian free trade agreement, see: Council of Economic Advisers: Economic Report of the President, Washington, D.C., 1988, Chap. 3.

<sup>9</sup> On the supply-side stability strategy of the USA and other industrial nations during the 1980s, see P. J. J. Wellens: Theorie und Praxis angebotsorientierter Stabilitätspolitik, Baden-Baden 1985; P. J. J. Wellens: Angebotsorientierte Stabilitätspolitik: Probleme, Erfahrungen, Perspektiven, in: Konjunkturpolitik, 33 (1987), pp. 185–210.

competition in the sense that they offer more suppliers a chance of survival in the long term. Even so, there are many industries where oligopolistic supply structures can be expected even when the EC's internal market is established. This makes the function of trade between EC and third countries all the more important, for export and import rivalry are an essential spur to competitiveness.

The creation of the EC's internal market will also largely put an end, from 1993 onwards, to the non-tariff barriers in Western Europe which have been a hindrance not only to trade within the EC but also to world trade as a whole. Diverging technical standards and the practice of giving preference to domestic suppliers in public procurement have always been regarded as particularly detrimental to trade, and also as an obstacle to the optimal exploitation of economies of scale. 1993 will see the emergence of new, EC-wide markets in major spheres of industry. To the extent that static economies of scale (falling marginal costs as production increases here and now) and their dynamic counterparts (falling unit costs due to learning effects dependent on cumulative production) do play a more significant part once the market potential increases, one must assume a tendency towards concentration will occur. Experience has shown that in industries where economies of scale prevail there is a tendency towards moves to crowd out competition. As Table 2 shows, previously protected industries can expect unit cost reductions of 5%-20% if the production volume is doubled, which amounts to a substantial incentive towards concentration. If one were to take the number of suppliers on the US market as a probable figure for the

number of companies in the same industry supplying the European internal market, this would mean the number of suppliers in established industries being more than halved. It is only in relatively young and innovative industries (the laser industry is an example) that the number of suppliers can be expected to remain very high. In such cases the competitive process generally also opens up numerous new fields of application for the pioneering technologies or products involved, which also create pressure to adapt production methods in highly concentrated industries. Thus the promotion of new technology which is compatible with market mechanisms and concentrates on such new "diagonal innovations", in other words which aims to support new developments right across the different branches of industry, can be regarded as added support for competition policy from industrial policy.<sup>10</sup> Given that intangible investments have grown more important in the OECD countries as the high-tech industries have developed, international competition to innovate and the trade in Schumpeterian, technology-intensive goods or in patents and licences truly are of extraordinary significance.<sup>11</sup> The globalization of markets, then, means that not only domestic competition policy but also trade policy is vitally important.

## Competition and Trade Policy in the EC

Since there has been an increase throughout the world economy in national export and import quotas on the one hand and in involvement abroad through direct investments on the other, external economic factors or those related to external economic policy inevitably have more influence on considerations as to how domestic competitive structures should be developed.

This is especially true in the EC countries, and is reflected in Article 86 of the EEC Treaty which states: "To the extent to which trade between any Member States may be affected thereby, action by one or more enterprises to take improper advantage of a dominant

<sup>10</sup> On the distinction between horizontal, vertical and diagonal innovation, and on the discussion concerning the importance attached to technology policy, see P. J. J. Welfens: *Innovationstheorie, -politik und -dynamik im Systemvergleich*, in: P. J. J. Welfens, L. Balcerowicz (eds.): *Innovationsdynamik im Systemvergleich*, Heidelberg 1988, pp. 1-27.

<sup>11</sup> On the growing importance of intangible investment, see: OECD: *Structural Adjustment and Economic Performance*, Paris 1987, p. 168.

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## KONJUNKTUR VON MORGEN

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position within the Common Market or within a substantial part of it shall be deemed to be incompatible with the Common Market and shall hereby be prohibited". The Brussels Commission's draft of an EC regulation governing mergers and acquisitions gave rise to intense discussions at the turn of the year 1988/89; this was particularly true of West Germany, with its relatively strict regulation of mergers by the Law against Restraints of Competition<sup>12</sup> and its Federal Cartel Office, though the latter is now in danger of falling victim to deliberate political obsolescence.

The moves to set the course for future merger controls in the EC are especially important in the light of the long-term tendencies towards concentration in the world economy described above. The fact that, in terms of population, the EC represents the largest industrialized sub-market within the world market system with its global competitive processes makes the competition policy pursued by the EC extraordinarily significant; because of the third-country effects they generate (whether on the USA, Japan or developing countries), national and supranational competition policies in the EC are of great importance for the "world system of allocation".

In future, the domestic competition law in any EC member country will not be able to be applied to mergers or acquisitions which are of Community-wide significance without the express permission of the EC Commission. In the event that competition is impaired, the possibility will nevertheless exist for mergers or acquisitions to be given the go-ahead if the economic advantages outweigh the disadvantages for a competitive market. This could lay the foundations for an EC industrial policy along French or Italian lines. Against the background of high unemployment in the EC

countries, the future brings a more serious threat of the type of politically opportune exemptions being granted which have occurred in West Germany under the heading of "ministerial permission", and which are regarded as problematic by allocation theory.

Moreover, it must be recognized as inconsistent for West Germany and other EC countries to join the USA in demanding free trade while at the same time creating distortions in domestic supply motivated by industrial policy to strengthen the global market position of major companies or industries – and this also means raising the barriers to entry for suppliers from the NICs (or LDCs).

It must appear inconsistent in the eyes of developing countries that West Germany and other industrial countries preach the liberalization of world trade according to the motto "more market economy in the world economy" – especially, during the current GATT round, that of trade in services – yet the competition monitoring authorities in just those countries pass over the abuse of market power or acts of collusion among subsidiaries of Northern multinationals in their foreign operations as being of little consequence. It has not so far come to anyone's notice, for example, that competition monitoring authorities in the USA or West Germany have made any investigations into the Brazilian joint-venture company Autolatina established by Ford and Volkswagen.

Intensified international competition for potential new investment which has resulted from increasing factor mobility, with keen rivalry around the world – both direct and indirect – to gain or retain jobs, and frequently also from considerable static and dynamic economies of scale, has also encouraged the tendency of political systems to undertake protectionist intervention in the economy; this is especially true of events in the EC countries during the 1980s. Those countries' subsidy-based agricultural protectionism has particularly negative effects as far as trade policy towards the Third World is concerned; in a similar situation to the agricultural sector, the policy of subsidizing the steel industry should also be regarded as a substitute for increases in tariff rates which would be identifiable as a clear breach of the principles of the GATT.<sup>13</sup> It is no

**Table 2**  
**Sensitive Business Areas in the EC with Regard to Integration Policy**

	Intra-Community trade	No. of EC manufacturers (cost red. <sup>1</sup> )*	US manufacturers
Steam-raising equipment	very small	12 (20 %)	6
Turbine generators	very small	10 (12 %)	2
Locomotives	very small	16 (20 %)	2
Mainframe computers	30 – 100 %	5 (5 %)	9
Telecom. equipment	15-45 %	11 (20 %)	4
Telephone equipment	very small	12 (–)	17
Lasers	large	> 1000	> 1000

<sup>1</sup> If production volume is doubled.

Source: Commission of the European Communities: Soziales Europa, Brussels 1988, p. 43; \* based on surveys conducted by Atkins (Enquiry into the costs of Non-Europe/public procurement).

<sup>12</sup> Gesetz gegen Wettbewerbsbeschränkungen (GWB). For the discussion on EC merger surveillance in the context of the planned fifth revision of the GWB, see in particular: Monopolkommission: Siebentes Hauptgutachten der Monopolkommission 1986/87, Bonn 1988; G. Meier: GWB-Novelle und Europäischer Binnenmarkt, in: Wirtschaft und Wettbewerb, 38 (1988), pp. 722-732; Monopolkommission: Conception of a European Merger Control, Baden-Baden 1989.

<sup>13</sup> On the exempted areas in EC competition policy and their effects on third countries, see H. Dicke et al.: EG-Politik auf dem Prüfstand, Tübingen 1987.

coincidence that it is precisely those areas which are partly exempt from competition which give rise to trade policy conflicts between the EC and the USA, Japan or the Third World. However, though Japan may be able to defend itself against the imposition of EC anti-dumping tariffs by taking recourse to the GATT, and also by threatening to take counter-measures of its own, these options are not available to most Third World countries (especially if, as in Taiwan's case, they are not signatories to the GATT).

The advances made by the NICs have led to considerable adjustment problems, particularly in the EC. Simultaneously, though, one is bound to ask whether the existing and new companies from the NICs are not exerting a positive function overall on the world market economy through the intensification of competition, in view of the frequently ossified markets in the industrial countries. Giving encouragement to the newcomers via a liberal trade policy and greater reserve in the use of subsidies, as would really be desirable, is hardly possible, at least in Western Europe, as long as the problem of long-term unemployment restricts the

scope available to economic policy. The NICs, meanwhile, have sought their own autonomous strategies for tapping the world markets in the 1980s, spurred on to no small degree by the pressures of persisting population growth and inspired by Japan's rise to economic greatness as well as their own development successes.

## Strategic Trade Policy in the NICs

Companies from Japan, the Asiatic NICs and Latin America making inroads into the world market often do so by pursuing a strategy of expansion into technology-intensive, and hence also usually capital-intensive, sectors of the economy; they are generally given deliberately targeted incentives and/or subsidies by the state to do this. Examples occur in the fields of steel-making, electronics and vehicle manufacturing, where it is suspected that high prices for the products concerned in the domestic market, possible because of the companies' market power at home, are used to cross-subsidize their international activities, as appears to be necessary to finance the low prices the newcomers need for a successful entry on to the world market.<sup>14</sup> The divergence between domestic prices in NIC multinationals' home countries and the prices at which their goods are supplied abroad is regarded as "dumping" and therefore in breach of the GATT by the

<sup>14</sup> A corresponding argument applies to cases in which preference is given to domestic suppliers when government contracts are awarded, an implicit payment of higher prices – relative to the world market – for the goods received, which ultimately have to be met out of taxpayers' money.

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Rasul Shams

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The number of developing countries which have signed agreements on structural adjustment with the IMF and the World Bank has increased rapidly in the eighties. At the same time, the discussion on the conflicts involved in such adjustment programmes has intensified considerably. Against the background of the belief that the success or failure of programmes, the way in which they are implemented, as well as the period of time in which they can be politically supported, are decisively determined by the activities of interest groups, the example of Turkey is subjected to an empirical analysis.

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USA and the EC countries. The Omnibus Trade Act passed in 1988, with its strong emphasis on the principle of reciprocity in trade, delivers what could be a potent weapon to the USA to resist such strategies for opening up new markets, and the positions the country has adopted during the current GATT round also suggest that it has renounced the principle of multilaterality.<sup>15</sup> The question nevertheless arises as to whether it would not be in the leading industrial countries' own interests to concede "softer" rules to developing countries and NICs than to the OECD countries with their high levels of technological advancement and per capita incomes, as indeed has been the normal GATT practice in the past.

In as far as it is actually possible to enter the world market by means of internal cross-subsidies as described above, moves to allow, encourage or deliberately create industry or supply structures restricting domestic competition can be seen as a reflection of the barriers to entry set up by established suppliers on the world market (or by the governments of industrial nations). The true characteristic feature of the world markets for industrial goods is oligopolistic competition, with knowledge-intensive areas showing particularly high barriers to entry by virtue of high investment and R & D costs specific to those areas (sunk costs, i.e. production-specific costs which are not recoverable upon leaving the market).<sup>16</sup>

Contrary to the traditional view, then, in the above perspective domestic distortions in the NICs are not a launchpad for external economic intervention on the part of these countries. Quite the reverse, these domestic distortions to competition are essential if the entry of newcomers into the world market is to be possible in spite of the oligopolistically distorted structures which are established there.

The "imitative specialization and diversification" which is characteristic of many successful NICs and hence also their devotion to intra-industry trade are out of line with the classical concepts of trade theory, yet are also incompatible with development models based on import substitution. The question is, therefore, how worthwhile, from a purely economic point of view, are domestic distortions designed to accelerate exports (e.g. world-market-oriented R & D assistance,

governmental procurement orders representing effective subsidies, etc.) and what effect do they have on the global allocation process? This is the question which the successful, export-oriented NICs need to try and answer, and to which an answer is provided by strategic trade theory.<sup>17</sup>

There are at least two cases in which a positive answer emerges:

□ When the appearance on the world market of new suppliers backed up by subsidies melts away the economic rent previously absorbed by the established companies and this, henceforward, has to be shared more equally; the country concerned will always derive a direct benefit if its domestic market has previously been supplied from abroad (a conceivable case would be if IBM reduced its prices in Japan as a result of the growth of a Japanese computer industry capable of competing in the world market).

□ When, at a given level of demand in the world economy, the country is able to benefit, via a rapid, export-oriented build-up of productive capacity, from static and from dynamic economies of scale, the latter deriving from a downward movement along the learning curve (falling unit costs dependent on cumulative production), and in doing so can push foreign competitors back up the hypothetical learning curve or place them in a situation where they refrain from previously planned expansions in capacity. Of course, the foreign countries affected may issue credible announcements of still higher R & D subsidies and/or public procurement support in order to deter any other country from developing its own capacity for domestic production and export.

This focuses attention upon the "strategy problem", in the sense used by games theory, and it is this aspect to which the new theory owes its name.

One surely can make the supposition that the NICs' race to catch up in technological and economic terms can be utilized as a factor in intensifying competition in the world economy; to the extent that the NICs deliver

<sup>15</sup> On the erosion of the principles of the GATT and discussions on reform, see H. Kitamura: GATT and Conflict Management, Duisburg (mimeo) 1988; on the trade policy disputes between the USA and the EC, see R. E. Baldwin, C. B. Hamilton, A. Sapir (eds.): Issues in US-EC Trade Relations, Chicago 1988.

<sup>16</sup> The significance of sunk costs as barriers to market entry is stressed in contestable market theory; see W. J. Baumol, R. D. Willig: Fixed Costs, Sunk Costs, Entry Barriers and Sustainability of Monopoly, in: Quarterly Journal of Economics, 96 (1981), pp. 405-431.

<sup>17</sup> On strategic trade theory, see: P. Krugman: Import Protection as Export Promotion: International Competition in the Presence of Oligopoly and Economies of Scale, in: H. Kierzkowski (ed.): Monopolistic Competition and International Trade, Oxford 1984, pp. 180-206. R. Baldwin: Evaluating Strategic Trade Policy, in: Außenwirtschaft, 43 (1988), pp. 207-230; P. R. Krugman (ed.): Strategic Trade Theory and the New International Economics, Cambridge, Mass. 1986. The first consistent formulation of the arguments of strategic trade policy in terms of a theoretical model can be found in J. Brander, B. Spencer: International R & D Rivalry and Industrial Strategy, in: International Review of Economic Studies, 50 (1983), pp. 707-722. On the empirical evidence, see: R. Feenstra (ed.): Empirical Research in International Trade, Cambridge, Mass. 1987.



intermediate products to companies in Japan, the USA and the EC, they also contribute indirectly to price competition in world markets. To the extent that they increase their technological ability to adapt with the help of their improved endowment of human capital and R & D resources, innovative rivalry in the leading industrial countries intensifies as they expect to be increasingly imitated by the NICs. However, as already shown, the new fields of technology in particular (e.g. lasers, but also software and biotechnology) are just the fields which allow plenty of scope for many new suppliers; as they discover new ways of combining factors of production, in accordance with Schumpeter's portrayal of innovation, these new companies in turn bring about restructuring processes and greater competition within the established industries.

### Perspectives

The arguments of strategic trade policy can become very dubious if used in the leading industrial countries. It only requires domestic production and international

marketing conditions to be given the right kind of interpretation for virtually any branch of industry to be able to present itself as worthy of state support during phases of recession or structural stagnation.

The modern key technologies (e.g. electronics, chemicals, motor vehicles) are crucially affected by static and dynamic economies of scale, which immediately makes clear the relevance of the interplay between trade and competition policy considerations. Another important area of policy as far as competition is concerned when production capacity is to be rapidly increased is stability policy, oriented in a Keynesian fashion to shoring up demand in the whole economy. Governmental stimulus to aggregate demand – especially if expansionary fiscal policy is part of an international concerted effort – not only means creating increased demand for declining sectors, but automatically also further stimulates expanding ones. Given the growing importance of industries with economies of scale, this gives rise to the special economic policy problem of "pseudo-excess capacity".

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### "Pseudo-Excess Capacity"

In countries with oligopolistic, economies-of-scale industries, economic policy faces problems of interpretation with regard to fluctuations in the level of capacity utilization. If companies use surplus capacity as a means of deterring potential newcomers by issuing credible threats that their entry would drive up the supply, and hence drive down prices, on the world market, it is possible for aggregate capacity surpluses to emerge which cannot necessarily be regarded as evidence of weak demand.

In this context, persistent reserve capacities have to be distinguished from "strategic product-cycle overhangs": the latter refers to a worldwide surplus resulting from the rapid increase in production capacity in an industry during the market launch and expansion phases which then, however, gradually disappears as demand catches up. Examples such as microchip production each time a new generation is brought out demonstrate that an international investment race can develop followed by ruinous price wars brought about by the excess capacity; the shorter the innovation cycle (defined as the number of periods before the transition to the next product generation occurs) and hence the closer the time-limit within which the economic rent for pioneering work and innovation has to be earned, the more aggressive are not only the price wars but also the attempts to buy up competing capacity.

The development of world markets on the one hand and of worldwide corporations based on direct investment or internal growth on the other have confronted traditional competition policy and trade policy with new challenges: world markets and worldwide corporations can only be influenced to a certain degree by national policies, and the increased international mobility of factors of production such as real, financial and technological capital encourages those companies to take cross-border evasive action. As existing or potential foreign competition increases in importance, there is a greater part to be played by import liberalization policy as a supplement to or even a

substitute for national policy when it comes to promoting competition; in this respect, trade and competition policy are closely interlinked.

As the world economy is no longer dominated by a single power as it was by Great Britain during the 19th century or the USA earlier in the 20th, but now appears to be developing a multi-polar structure, it will be most important in future to develop a world competitive order in a spirit of political cooperation. However, because at least three leading players – the EC, the USA and Japan – with differing business cultures and divergent ideas on the interplay between the economy and the government will have to work together, compromises will inevitably have to be made. At the same time, efficient solutions involving international cooperation need to be found for the international monetary system, for the capital account is a mirror image of the current account, which means that international disruptions in the field of foreign exchange policy necessarily have knock-on effects upon the real economy (and vice versa).<sup>18</sup>

If national economic policy is to retain the manoeuvring space it needs in the fields of competition and trade policy in order to solve the allocation problem efficiently, the political system must demonstrate greater sensitivity for the growing concentration of economic and political power which can be expected to develop. The politico-economic problem arising in conjunction with a competitive order and a trading order is precisely that these are "collective goods" and therefore constantly in danger of being qualitatively eroded: the eroding factors are interventions which are injurious to efficiency and freedom, made by private or governmental entities which are both well-organized and clearly definable in terms of the exclusiveness of the benefits derived from bending or indeed breaching the rules.<sup>19</sup> Regulatory reforms and privatization schemes in the world economy are becoming a matter of increasing urgency in view of the fossilized state of operating conditions in many industrial and developing countries.<sup>20</sup> In the 1990s, during which not only the EC/EFTA-USA-Japan triangle but increasingly also the NICs in Latin America and South-East Asia will play an important part in the world market economy, it will be crucial for that economy that a consistent combination of competition and trade policy should be achieved within the framework of internationalized policy concepts, thus contributing to the continued development of a liberalized world economy.

<sup>18</sup> This lesson from the problems arising under the Bretton-Woods system, also noting the complementarity of the GATT regulatory system and the activities of the IMF, is stressed by A. Gutowski: *Internationale Währungsordnung und weltwirtschaftliche Entwicklung*, in: H. Giersch (ed.): *Probleme und Perspektiven der weltwirtschaftlichen Entwicklung*, Berlin 1985, pp. 307-332, esp. p. 318.

<sup>19</sup> The fact that the international competitive order and international competition policy have the quality of a collective good is also a major reason behind the failure of earlier attempts at reform such as the League of Nations proposals on the question of international cartels; see H. Gröner: *Internationale Wettbewerbspolitik*, in: M. Borchert, U. FehI, P. Oberender (ed.): *Markt und Wettbewerb*, Berne 1987, pp. 359-377, esp. p. 360.

<sup>20</sup> On this, see D. Cassel, B.-T. Ramb, H.J. Thieme (eds.): *Ordnungspolitik*, Munich 1988; P. J. J. Wellens: *Internationalization of the Economy and of Economic Policies*, Heidelberg 1990 (forthcoming).