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Falling behind or catching up? Developing countries in the era of globalization

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Falling Behind or Catching Up? Developing Countries in the Era of Globalization

by Erich Gundlach and Peter Nunnenkamp

CONTENTS

- Globalization improves the prospects for developing countries (DCs) to catch up economically with industrialized countries. But not all DCs will automatically benefit from globalization. Some DCs even face the risk of being delinked from the international division of labor. Differences in DC economic policies ultimately determine whether there will be a deepening divide between rich and poor countries in the world economy.
- Many observers draw an overly pessimistic picture of the perspectives of DCs in the era of globalization because of missing institutionalized links to regional integration schemes in Europe and North America, a low level of interfirm technology cooperation between industrialized countries and DCs, and a high concentration of foreign direct investment (FDI) flows on only a few DC hosts. However, such concerns are largely unfounded:
 - Asian DCs are most successful in globalization although they have remained outside institutionalized integration schemes, while ACP countries have not made much progress despite their preferential access to EU markets.
 - Technology transfers between industrialized countries and DCs mainly occur through FDI and trade in capital goods, rather than through interfirm technology cooperation. Recent trends in FDI and international trade strongly support the proposition that DCs have become closely integrated into globalization strategies.
 - A high concentration of FDI flows on a few DC hosts does not imply that new attractive locations cannot compete for international capital. Admittedly, it is true that between two thirds and three quarters of total FDI flows to DCs have persistently been absorbed by ten host economies. But the country composition of this group has changed over time.
- Globalization implies an increase in international investment cooperation. Case studies for selected DC industries show that FDI prevails in industries applying sophisticated technologies, whereas licensing and subcontracting are favored when production processes are standardized. Policy interventions may limit the choices open to investing foreign firms and, thereby, cause substitution effects between different forms of globalization or hinder globalization at all.
- The quality of DC economic policies determines whether these countries will succeed in joining the globalization club. The experience of the frontrunners among DCs suggests some basic policy conclusions:
 - Openness towards world markets is a precondition for becoming involved in globalization strategies of transnational corporations. Liberalizing all forms of international investment cooperation and removing barriers to international trade should rank high on the policy agenda of DCs.
 - Under conditions of globalized production, DC governments are increasingly constrained in pursuing policies of their own liking. Those DCs characterized by pronounced macroeconomic instability are relatively unattractive locations for international investors.
 - Investment in physical and human capital plays a crucial role in enabling DCs to participate in globalization. Economic policies that discourage domestic saving and investment must be avoided. Financial market reforms are needed in DCs characterized by financial repression and inefficient intermediation between savers and investors. A better education of the workforce is required for a successful application of new technologies that become available through globalization.

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A. Driving Forces of Globalization

Looking back, next generation's economists may be puzzled by the structure of the world economy of 1995. Today, developing countries (DCs) and the former Soviet bloc account for about one half of world output and the rich industrialized countries for the other.¹ But this picture is likely to change rapidly over the next 25 years: At current growth rates, the rich world's share of global output could shrink to less than two fifths by 2020. Although the absolute magnitudes are uncertain, it is safe to assume that there will be an enormous shift of economic power from today's rich countries to what is still labelled DCs, and especially to Asian DCs.² This shift is the likely result of the ongoing globalization of economic activities, i.e., the increasing worldwide integration of markets for goods, capital and last not least, labor.

Globalization refers to an evolving pattern of cross-border activities of firms involving international investment, trade and cooperation for purposes of product development, production and sourcing, and marketing. Complex patterns of cross-border activities increasingly characterize the international economic system and distinguish it from the earlier predominance of arm's length trade in finished goods. Taken at face value, globalization is by no means a principally new phenomenon, since the globalizing economy is first and foremost an expression for an increase in the international division of labor. What is different this time is the sheer weight of new competition, the new mobility of capital and technology, and the fact that more Third World workers are educated and so capable of operating even complex machinery. Hence, economic power is dispersed among more actors, and interregional competition is heightened. Does this process end up in a deepening divide between rich and poor countries, or will the next 25 years be a time of unprecedented opportunity for DCs? And will globalization foster or retard their industrialization? To answer such questions, it is necessary to understand why global-

ization has emerged and how it actually proceeds.

The main driving force behind globalization strategies of firms is not different from what drives international trade. Firms seek to maximize profits, given the constraints they face. Changing or vanishing constraints imply new profit opportunities and thus require new strategies of firms. In a way, globalization is nothing more than the entrepreneurial response to a changing environment, while the leitmotiv of firm behavior — constrained profit maximization — remains unchanged.

One of the most important reasons for globalization is that large parts of the world have become industrialized since the Second World War. Many DCs, especially in East and Southeast Asia, have attained, or are about to attain, the status of an industrialized country. This successful catching-up has increased the number of suppliers on world markets. Global production capacities and international competition have increased, and so have the opportunities to exploit market niches. This process will gain momentum once the large markets of the P.R. of China, India and Central and Eastern Europe, which represent roughly one half of the world's population, will be fully integrated into the world economy. Put differently, the constraint of market size, which may have hindered globalization strategies in the past, has become less relevant and probably no longer applies at all.

At the same time, other constraints that prevented firms from implementing globalization strategies have disappeared. Thanks to the microelectronics revolution, communications technologies have undergone a dramatic change during the last decade, and new production and organization technologies such as CAD (computer-aided design) and CIM (computer-integrated manufacturing) have evolved. Successive GATT rounds have substantially reduced tariff barriers to trade, and capital markets have also been liberalized, especially during the 1980s.

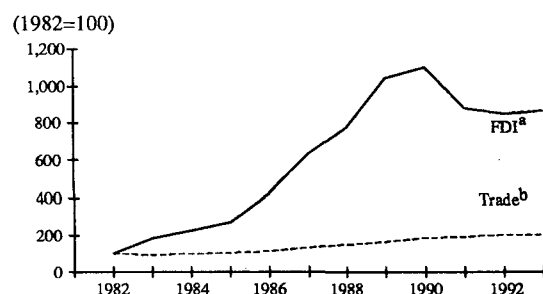
Many business services have become internationally tradable. As transaction and communications costs fall, the proximity between sellers and buyers, which has traditionally been considered to be essential for many services, figures less prominently. Most important in this regard is that financial capital has gone global. Nowadays, the financial centers of the world economy provide the possibility for 24-hour trading in all sorts of financial assets. The deregulation of other business services such as banking and insurance also offers new opportunities for the tradability of services. Hence, standardized business services have become available around the world, which, in turn, has made the international fragmentation of production feasible. As a consequence of all this, not only the constraints for firms, but also for governments have completely changed.

Globalization shapes the world economy in different ways. Most obviously, international trade and capital flows are affected. Over the last 30 years or so, international trade has grown faster on average than production (GATT various issues), implying a more integrated world economy. Closer integration brings about opportunities for specialization, and hence increases interdependencies. This is highlighted by changes in the structure of world trade. For example, international sourcing, i.e., the purchase of intermediate inputs from foreign sources, has grown faster than domestic sourcing and now accounts for about half of all imports by major countries (OECD 1994d); intraindustry trade has risen significantly in almost all OECD countries, and also between Japan and its Asian neighbors in physical and human capital-intensive products, while intrafirm trade seems to have kept pace with the increase in total trade (Nunnenkamp et al. 1994).

In contrast to relatively steady changes in the pattern of international trade, especially during the last decade, a dramatic increase in the international redistribution of ownership has taken place. Flows of foreign direct investment (FDI), for instance, have grown even three to four times faster than international trade (Figure 1). In addition to rising FDI flows, other forms of international investment cooperation such as li-

censing, joint ventures, offshore processing, minority participations, and so-called strategic alliances have become more important in recent years. As a rough approximation, the number of international interfirm cooperation agreements has doubled over the 1980s (OECD 1994d). These cooperation agreements tend to involve large firms from Europe, the United States, and Japan, and they are concentrated in sectors such as electronics, aerospace, telecommunications, computers and automobiles.

Figure 1 – World FDI and Trade Flows, 1982–1993



^aTotal FDI outflows. — ^bWorld merchandise exports plus exports of commercial services.

Source: GATT *International Trade, Trends and Statistics* (various issues), IMF *Balance of Payments Statistics Yearbook* (various issues).

Although all three aspects of globalization — international trade, FDI, and international interfirm cooperation — are dominated by OECD countries so far, the dynamic East and Southeast Asian economies are rapidly becoming involved, as are some countries in Latin America and in Central and Eastern Europe. Given its current move towards economic reform, India may be the next giant eagerly waiting to join the globalization club. Those DCs which have already joined appear to have two things in common, despite rather dramatic differences in per capita income:³ a domestic economic policy which is compatible with an integration into world markets, and a large supply of workers which have received at least a minimum amount of formal education at school. Improvements in formal education, i.e., increases in the average years of schooling, enable workers in DCs to compete with low- and medium-skilled workers in rich

countries if governments do not hinder international trade and capital flows. No wonder, public debate considers globalization mainly as a threat to labor markets in industrialized countries. Consequently, recent studies focus on the implications of globalization for earnings and employment prospects of low-skilled workers in rich countries (Lawrence and Slaughter 1993; Nunnenkamp et al. 1994; Wood 1994). The implications of globalization for DCs, however, have so far largely escaped the attention of the economics profession.

In the following, we try to change this unsatisfactory state of affairs. We portray the ongoing process of globalization involving DCs, and discuss why the gains from globalization are un-

evenly distributed among DCs up to now. Chapter B reviews the rationale behind different globalization strategies which are relevant with respect to DCs. Chapter C presents an overview of recent trends in international business cooperation through non-equity interfirm alliances and FDI in DCs. Chapter D examines the implications of globalization for selected industries in DCs. Chapter E tries to assess the future position of DCs in the global economy, thereby highlighting the determinants for attracting foreign risk capital, the role of new technologies, and the risks involved in current policy trends in industrialized countries. Chapter F summarizes the main findings.

B. Major Forms of Globalization

Globalization proceeds through different means.⁴ What they have in common is some kind of international interfirm cooperation, usually involving cross-border flows of technology, goods, capital, or intangible assets, or combinations of these. The specific instrument chosen for participation in worldwide production, sourcing and marketing depends on a number of country-, industry-, and firm size-specific characteristics. The whole spectrum of possibilities firms can choose from for going global ranges from traditional arm's length trade to FDI. In the former, international interfirm cooperation is restricted to conventional forms of selling and buying goods or services, without any changes in the respective ownership of firms. In the latter, ownership is redistributed internationally, typically through exchanges of majority equity stakes. In between these two extremes there is a grey area where so-called non-equity forms of cooperation (NEC) dominate alliances between domestic and foreign firms.

I. NEC versus FDI

NEC covers a broad and heterogeneous range of cross-border activities of companies. They in-

clude in particular: R&D cooperation; joint ventures with minor foreign equity stakes; the supply of technology or trademarks through licensing agreements; production sharing arrangements, international subcontracting that involves firms with a local majority stake; as well as contracts on franchising and turnkey projects. The common denominator of the various types of NEC is that tangible or intangible assets are supplied by a foreign company to a local enterprise, while local interests in the host country retain majority or full ownership. The foreign company's equity stake, if any, does not constitute ownership control, though NEC may entail a significant degree of effective control by other means.

It should be noted that there is no unanimous border line of foreign equity stakes that would adequately serve to distinguish NEC from FDI (see also IMF 1977). The relevant criterion for FDI is that the foreign investor has an effective voice in the management of an enterprise. Yet effective control does not only depend on the proportion of foreign equity stakes, but also on whether the remaining shares are widely dispersed or rather concentrated. Such information required for clear-cut differentiation between FDI and NEC is generally not available. Conse-

quently, there is no alternative but to refer to the proportion of foreign ownership in defining FDI. The border line applied differs considerably between different sources. In balance of payments statistics the percentage chosen is typically quite low, ranging from 25 percent down to 10 percent.

Furthermore, the relation between NEC and FDI is not straightforward from an analytical point of view. The ambiguities are similar to those known from the trade-FDI nexus and largely stem from economic policy interventions. The positive effect of past and present exports on FDI, postulated by the theory of optimal timing of FDI, may be neutralized if large and important markets are not accessible via exports and if FDI is undertaken to overcome protectionist trade barriers. Trade liberalization may then have even a negative effect on FDI. Similarly, NEC may be a second-best alternative to FDI if the latter is regulated or even prohibited. Globalization through NEC might then become less relevant once FDI restrictions are lifted.

II. Substitution Effects between NEC and FDI

Substitution effects between NEC and FDI (as well as trade and FDI) reflect that corporate strategies and government regulations are intertwined. Until the early 1980s, many countries were concerned about "foreign dominance" by transnational corporations (TNCs) in their economies. Especially in DCs, globalization through FDI was hindered by a host of restrictions, ranging from not permitting any foreign equity investment in strategic industries to performance requirements in terms of local content and export obligations.⁵ Such a restrictive policy stance left no alternative but to globalize via NEC, or at least increased the attractiveness of NEC relative to FDI. At the same time, a recourse to NEC suggests that entrepreneurial adaptation to policy interventions reduced the effectiveness of the latter in achieving the host country's objective to limit foreign involvement in the economy. Given that NEC, too, involved effective control by foreign companies, majority

ownership by the host countries was insufficient to guarantee exclusive local control.

The limited effectiveness of government regulations may have contributed to the more liberal stance towards FDI since the 1980s.⁶ In many DCs, however, the significant relaxation of FDI restrictions was an attempt to overcome foreign exchange constraints and to improve the chances for a closer integration into the world economy. Even if higher FDI inflows were induced by such a move, the effectiveness of the policy change may again suffer from substitution effects. A rise in FDI would then go hand in hand with less globalization through NEC; if so, an earlier rise in NEC would turn out to be temporary.

Policy-induced substitution effects notwithstanding, the degree of globalization is likely to be underestimated when NEC is ignored. Two factors are of particular relevance with respect to the growth of NEC: (i) general changes in TNC perceptions on the advantages of NEC, which are of a longer-term nature and independent of policy-induced biases in corporate decision making, and (ii) industry characteristics that have as a consequence that NEC is the superior way of globalization in certain sectors, while there may be no alternative to FDI in other sectors.

While FDI provides a way for the host country to share economic risks with foreign investors, TNCs may aim at risk diversification by unravelling the FDI package. NEC offers various options to this effect. Political risks in general, and expropriation risks in particular can be contained in the case of joint ventures with local majority stakes. By providing intangible assets through licensing, investment and operation costs are shifted to local or other foreign partners. Subcontracting implies that the effects of fluctuations in final demand are shared with the subcontracting firm in the host country. Financial risks can be diversified by delegating the financing of investment projects to commercial banks.

The favorable risk properties of NEC render it easier for newcomers to go global, especially in the case of smaller companies for which the potential of intrafirm diversification of risks is

limited.⁷ For these companies, NEC offers the opportunity to compete with established TNCs in world markets, despite an internationally less diversified equity structure. As a consequence, more FDI by market leaders is likely to provoke more NEC by market followers. FDI and NEC can thus be expected to be complements rather than substitutes.

III. Industry Characteristics and International Investment Cooperation

Industry characteristics can also explain why different corporate globalization strategies are followed at the same time. It is well known from the eclectic theory of FDI (Dunning 1977) that owners of intangible assets prefer to maintain control over the use of such assets if external markets are inefficient and the transfer of assets through market exchange involves high transaction costs. Hence, it can reasonably be assumed that the suitability of different globalization strategies depends on the asset-specific significance of market imperfections and transaction costs. For example, market inefficiencies are supposed to have an impact in the case of ownership advantages related to products and marketing so that internalization is most likely to occur through FDI (Kumar 1989). As concerns ownership advantages related to process technology, the propensity to FDI is expected to be relatively high in the case of innovative technologies, whose management requires particular skills of the owner's employees. By contrast, licensing is expected to be a prime vehicle of

globalization if standardization is well advanced (Caves 1974; Teece 1981).

The importance of intangible assets related to products and markets, and the technologies applied vary across industries. Hence, the propensity to internalize and the preferred mode of internalization will be industry-specific (Dunning 1981; Kumar 1989). Globalization may be dominated by FDI in industries producing differentiated goods, for the sale of which brand names and quality control feature prominently. The same applies when globalization necessitates the transfer of highly skilled personnel, for example, for purpose of management and organization, marketing, and R&D. By contrast, NEC may be favored in industries where knowledge is embodied in capital goods, production processes do not require extensive supervision, and the R&D intensity of production is low.

Finally, country characteristics may shape globalization strategies. DCs may prefer FDI in some industries and NEC in others. Many DCs have built up considerable domestic capacities in management, technological development, and marketing. Depending on the advances made in these areas, they may rely on local resources to the largest extent possible in order to reduce foreign exchange costs (Oman 1989). Consequently, they will prefer NEC in industries that can be run locally once specific assets are supplied from abroad, for example through licensing. By contrast, the package of foreign assets typically embodied in FDI will be welcomed particularly in industries where the bundle of necessary inputs is generally not available locally.

C. Overview of Recent Trends in International Business Cooperation

I. Empirical Evidence on Non-Equity Cooperation with DCs

Any empirical assessment of the significance of NEC and its relation to FDI suffers from serious data shortcomings. This is all the more so in the

case of DCs. In contrast to the comprehensive, though not always consistent data collection on FDI, the available statistical information on NEC is fragmentary and incomplete, especially with respect to DCs. Contractual arrangements between companies of different legislations largely escape balance of payments statistics.

The flow of goods, services and income induced by such arrangements is typically hard to identify, as the relevant items are included in more broadly defined statistical categories. Finally, FDI and NEC are sometimes difficult to disentangle.

Notwithstanding the lack of comprehensive data on NEC, there appears to be a fairly broad consensus that globalization has not only been pursued via FDI but also through various forms of collaborative ventures.⁸ Some empirical support for this view comes from the Maastricht Economic Research Institute on Innovation and Technology (MERIT), which runs a data base on more than 10,000 ventures (Hagedoorn and Schakenraad 1990: Appendix I).

This source basically relies on newspaper reports on business events. Two obvious limitations are that deals between small and medium-size firms (SMEs) are more likely to go unrecorded, and that dissolution agreements are unlikely to be published. A selection bias also results from the fact that the MERIT data base only includes interfirm agreements that contain some arrangements for transferring technology or cooperating in research; mere production or marketing joint ventures are not taken into account. Furthermore, although partnerships involving majority ownership are explicitly excluded, some cases may include equity participation large enough to qualify as FDI. These shortcomings notwithstanding, the MERIT data base provides the most comprehensive systematic stocktaking of international interfirm cooperation agreements up to now.

The MERIT data (Hagedoorn and Schakenraad 1990) reveal that the most commonly cited reasons for interfirm cooperation agreements *which involve some form of technology transfer* were to gain access to a market, to exploit complementary technologies and to reduce the time required for innovation. Taken together, these motives account for more than 80 percent of all cases considered. It is interesting to note, however, that *basic* R&D is rarely found to be a subject of cooperation, as it only accounts for 4 percent of all alliances reported. This is probably because basic R&D concerns the core activity of companies, which they are reluctant to

share with other independent firms. This finding supports the above proposition that different globalization strategies are complementary to each other, the mode of globalization depending on the importance and specificity of particular corporate assets and the asset-specific transaction costs involved.

As expected, the relative importance of different motives to enter interfirm cooperation agreements varies between sectors. Technological complementarity and reduced innovation periods are less relevant in motivating cooperation in mature industries. The latter comprise chemicals, consumer electronics, food and, to a certain extent, also the automobile industry, which together account for 17 percent of the total number of alliances. Market-related motivations dominate in these industries. By contrast, technology-related motivations dominate in biotechnology, new materials, industrial automation and software, and partly also in aviation. However, alliances with respect to basic R&D activities are of minor relevance in most of these sectors, too. This suggests that even for those alliances which aim at some sort of technology transfer, interfirm cooperation is not the preferred globalization strategy when it comes to highly firm-specific assets and the core activities of companies. In these cases, FDI seems to dominate.

This general picture gives some clues as to the expected empirical pattern of interfirm technology partnering between industrialized countries and DCs. If, as suggested by the MERIT data base, more than half of all interfirm technology partnerships can be explained by the motives "reducing innovation time" and "searching for technological complementarities," cooperation in this area can be expected to be largely a game between equally advanced players with a similar level of technological capabilities. Interfirm technology partnering within the Triad will then dominate, especially in technologically advanced sectors where the above mentioned motives have a still higher weight. Cooperation between firms from the Triad and DCs would not provide the required match of partners involved and is, thus, rather unlikely in this area. If any, Triad-DC technological coop-

eration should have a role to play in more mature sectors, for which market-related motives have a larger weight. It must be recalled, however, that the MERIT data base displays a sample selection bias as it only considers interfirm cooperation agreements which involve some transfer of technology: While it does make sense to expect a transfer of technology between rich and poor countries, a priori it is not clear why this transfer should proceed through interfirm cooperation, rather than through FDI which would allow the investing partner to maintain control over the technology transferred.

In analyzing patterns in international interfirm technology partnering, Freeman and Hagedoorn (1994) differentiate between what they call "strategic technology partnering" and "interfirm technology transfers." The first category subsumes agreements such as joint R&D and other innovative activities, while the latter includes agreements whereby one company provides access to its technology to another company, with licensing agreements as a leading example.

The international distribution of strategic technology alliances in 1980–1989 is reported in Table 1. These alliances are further classified by mode of cooperation and by field of technology. Taken at face value, the overall numbers indi-

cate an extremely high concentration of strategic technology partnerships among industrialized countries. Over 95 percent of the strategic technology alliances have been established between companies from industrialized countries, and just 2.3 percent between a Triad company and a firm from one of the newly industrializing economies (NIEs); a meagre 1.5 percent cover alliances between Triad companies and companies from less advanced DCs (LDCs). While the involvement of DCs, notably LDCs, in strategic technology partnering is generally small, some additional information can be gained from the structure of international strategic alliances.

First, considering the mode of cooperation, the relative importance of strategic alliances for firms in DCs is largest in the category "joint ventures," which is defined as including a number of corporate objectives other than R&D. By contrast, the weight of DCs is extremely low with regard to joint R&D activities. This is almost so by definition, considering the less advanced technological capabilities of DC partners. As argued above, their marginal involvement in joint R&D does not imply that DCs are delinked from technology transfers. Rather, strategic alliances are largely irrelevant in this respect.

Table 1 – International Distribution of Strategic Technology Alliances, 1980–1989

	Number of alliances (percent of total)		Share of (percent)		
			Developed economies	Triad–NIEs	Triad–LDCs
Total	4,192		95.7	2.3	1.5
<i>By mode of cooperation</i>					
Joint R&D	1,752	(41.8)	99.1	0.5	0.4
Joint ventures	1,224	(29.2)	90.9	4.9	3.4
Minority investments	684	(16.3)	95.8	2.0	0.1
R&D contracts etc.	532	(12.7)	96.6	2.6	0.2
<i>By field of technology</i>					
Biotechnology	846	(20.2)	99.1	0.4	0.1
Medical	95	(2.3)	100.0	0	0
Computer	199	(4.7)	98.0	1.5	0.5
Software	346	(8.3)	99.1	0.6	0.3
Automotive	205	(4.9)	84.9	9.8	5.4
Chemical	410	(9.8)	87.6	3.9	7.1
Microelectronics	387	(9.2)	95.9	3.6	0
Misc. information	148	(3.5)	93.3	5.4	0.7
Food and beverages	42	(1.0)	90.5	9.5	0

Source: Based on Freeman and Hagedoorn (1994).

Second, the classification by field of technology indicates that the observed pattern is influenced by the technological intensity of sectors. Strategic alliances within the Triad strongly dominate in high-tech sectors such as biotechnology, medical technology, computers and software. There is a larger role for strategic alliances involving DCs in relatively mature fields such as automotive technology, chemicals (the only case in which Triad-LDC alliances are more numerous than Triad-NIE alliances), microelectronics, and food and beverages. Firms from Asian NIEs figure most prominently on the side of DCs.

Not surprisingly, a similar pattern reemerges from the analysis of interfirm technology transfer agreements, derived from a smaller sample of 1,700 cooperative ventures. In the definition used by MERIT, technology transfers mainly include licensing agreements, technology sharing agreements, and joint ventures with a licensing agreement. Again, interfirm cooperation within the Triad dominates the sample, although to a somewhat lesser extent than in the case of strategic alliances. About 90 percent of all technology transfer agreements registered are between industrialized countries. Triad-NIE technology transfers account for about 6 percent, and Triad-LDC deals for about 4 percent. With regard to the sectoral distribution, the pattern found for strategic alliances is repeated by and large. However, substantial shares of technology transfer agreements between firms from the Triad and Asian NIEs are reported for automotive technology and microelectronics (about 20 percent) as well as consumer electronics (about 10 percent) (Freeman and Hagedoorn 1994). The somewhat larger weight of DCs, and especially the considerable involvement of Asian NIEs, confirms a priori expectations. Interfirm technology transfers, as defined by MERIT, are much less R&D-intensive than strategic alliances. Accordingly, cooperation between partners at different stages of technological development seems to be a more reasonable alternative to FDI in this category.

Two examples for technologically motivated alliances illustrate some characteristics of technology cooperation between Triad and DC firms

(San 1992), namely the joint venture between Taiwan's Acer Group and Texas Instruments in the field of information technology, and alliances between government-backed firms in Taiwan (NDL and IIS) and IBM in the software industry. In both cases, the aim was to upgrade the technological capabilities of Taiwanese firms, and to improve their marketing in domestic and foreign markets. The experience of Taiwan suggests that strategic alliances with foreign partners are more likely to be established by larger and more capital-intensive enterprises. Hence, differences in factor endowments could be another reason for the rather limited evidence of technology partnerships between Triad and DC firms, considering that enterprises in DCs are generally less capital-intensive than in industrialized countries.

Tentative empirical evidence on the structure of Triad-DC business alliances which do not exclusively focus on the transfer of technology, may be derived from a 1991 survey of Canadian industrial and merchandising companies. These companies had established alliances with firms in eight countries in East and Southeast Asia (Hung 1991, 1992) (Table 2). As can be expected for cooperation between unequal partners, more than two thirds of the business alliances were market-oriented, i.e., the underlying motive of Canadian firms was to gain access to local markets. Production- and technology-oriented alliances taken together only accounted for about one fifth of all cases. The figures also indicate that relatively advanced DCs have better

Table 2 – Distribution of Canadian Interfirm Alliances with Partners in Asian DCs, 1991

Type of agreement	Number of alliances (percent of total)	Share of (percent)	
		NIEs ^a	Other DCs ^b
Technology-oriented ^c	30 (15.9)	56.7	43.3
Production-oriented ^d	12 (6.3)	58.3	41.7
Market-oriented ^e	128 (67.7)	59.4	40.6
Others	19 (10.1)	52.6	47.4
Total	189	58.2	41.8

^aHong Kong, Singapore, South Korea, Taiwan. — ^bIndonesia, Malaysia, Philippines, Thailand. — ^cCollaborative research, technology transfer, licensing. — ^dContract manufacturing. — ^eMarket development, local distribution.

Source: Based on Hung (1991; 1992).

prospects to participate in business alliances: in every category, NIEs are involved more frequently than other DCs. Put differently, the division of labor between unequal partners is more likely to proceed through other instruments than NEC.

Selective evidence on business alliances between firms from India and the US, dating back to the mid-1980s, confirms the predominance of market-oriented motives, rather than technology cooperation (Parvatiyar and Gupta 1994).

The main reason for US firms engaging in India was to establish a production base in the large Indian market. Apparently, the choice of instruments was influenced by government regulations. Foreign corporations were allowed to collaborate with Indian businesses in three basic ways: licensing of technology without equity participation, joint ventures with foreign equity capital, and outright purchase of technical know-how in the form of design and drawings. Other forms of international cooperation (such as franchising and production sharing) were rarely permitted by the Indian government. Outstanding examples of joint ventures included: India's Tata Steel and Timken, a US producer of bearings; India's Modi Group and Xerox in the area of office automation; and Composite Tools, a joint venture between a US firm (Precision Carbide Tools) and an Indian entrepreneur, which was unique in the sense that the partners were aiming at exports exclusively. In essence, all examples represent marketing alliances, with US product technology and market experience complementing the relatively cheap manpower available in India.

Past research on globalization has focused on large TNCs. Yet there seems to be a role for smaller firms in international markets, and in international investment. The opportunities for smaller firms are simply different from those for larger TNCs. Because of their limited and specialized resources, SMEs may be best advised to compete in niche markets in which margins are higher, but economies of scale and scope are less important. Their activities are often less spectacular and, therefore, receive less publicity than TNC activities.

A recent study on interfirm cooperation strategies of Canadian SMEs in the Asian-Pacific region (Dhingra 1991) revealed that these firms do not behave systematically different than the average firm from the MERIT data base. *First*, it was found that Canadian SMEs display a relatively high tendency to enter the markets of developed or newly industrializing countries, both by equity joint ventures and non-equity contractual alliances, rather than markets of less advanced DCs at the Pacific Rim. Strategic alliances of SMEs in high-tech areas (aircraft, computers, etc.) are more concentrated in industrialized countries; alliances in rather traditional and mature industries are more localized in DCs. *Second*, many of the non-equity alliances were concluded in capital goods industries; equity joint ventures prevail in industries like electrical equipment, electronics, and mining and forestry. *Third*, most non-equity alliances of Canadian SMEs were found to be related to marketing contracts, which is in accordance with the *general* pattern of Canadian interfirm cooperation in Asia (Hung 1991, 1992). *Fourth*, the smaller the firm the more likely seems to be the recourse to NEC as compared to FDI.

The selective empirical evidence on NEC does not allow far-reaching conclusions, particularly as concerns the involvement of DCs in interfirm cooperation. The tentative pattern of international business alliances emerging from various sources suggests, however, that the respective factor endowments of cooperation partners play a significant role, in addition to government regulations and presumed market inefficiencies. In high-tech sectors, strategic alliances are mainly motivated by technology *cooperation*. Triad-DC partnerships do not figure prominently here, as a lower degree of technological capability is just one of the constituent properties of DCs. Although conclusive cross-country evidence does not exist, business partnerships with DC firms seem to be more important when it comes to standardized production and, especially, to market-oriented cooperation. Taken together, technology appears to be transferred to DCs mainly by other means than NEC, namely by international capital flows.

II. The Attractiveness of DCs for Foreign Capital

In the following, the focus is on FDI which, as mentioned earlier, is the most obvious (and relatively well documented) indication of a country's locational attractiveness in the era of globalization. A first and rather simple test whether DCs have become more integrated into the world economy is presented in Table 3.⁹ The globalization hypothesis implies that the significance of trade and capital flows should increase for countries successfully participating in the more elaborate international division of labor. Specifically, exports should grow faster than production (proxied by GNP), and FDI inflows should grow faster than exports.¹⁰ The export-to-GNP ratio (since 1987) and the FDI-to-export ratio did indeed increase for the aggregate of all DCs.¹¹ Booming FDI flows to DCs have caused a tenfold rise in the latter ratio since 1980, while the increase of the former has been rather moderate. However, the average development for all DCs obscures remarkable differences between various country groups.¹²

Both indicators show that it is mainly East Asia which has become more integrated into the international division of labor. This region stands out in two respects: (i) it is the only one for which export growth surpassed production growth significantly over the whole period under consideration; (ii) the FDI-to-export ratio reveals a record increase (9 percentage points) and is now higher than in Latin America, which was

the traditionally preferred investment location of US and European TNCs.

The main reason for this outcome was that East Asia's integration into the world economy proceeded along with domestic liberalization. ASEAN countries, the P.R. of China, South Korea and Taiwan relaxed FDI restrictions, notably since the mid-1980s (Chen 1993; ADB 1990).¹³ At the same time, various East Asian economies reformed their trade regime (Langhammer 1995; Riedel 1991): nontariff barriers were replaced by tariffs, tariff escalation was reduced, and both tariffs and quantitative import restrictions were dismantled unilaterally. Import liberalization supported specialization according to world market prices and rendered export expansion sustainable.¹⁴ That is, greater openness was obviously a precondition for booming FDI.

The integration of other DC groups into the world economy is less advanced, which may infringe upon their chances to benefit from globalization trends. In Sub-Saharan Africa, the export-to-GNP ratio stagnated over the whole period under consideration and the FDI-to-export ratio remained fairly low. The latter is also true for South Asia and the Middle East (including North Africa). It cannot be concluded from all this, however, that globalization works against DCs except for East Asia. Developments over the past 15 years are ambiguous in the case of Latin America. On the one hand, the export-to-GNP ratio is still on the decline, which may indicate that trade policy reforms have remained insufficient to establish closer trade links with the rest of the world. On the other hand, the

Table 3 – The Integration of Selected DC Regions into the World Economy, 1980–1994

	Exports in percent of GNP					FDI inflows (net) in percent of exports				
	1980	1987	1990	1992	1994 ^a	1980	1987	1990	1992	1994 ^a
All DCs	30.3	20.5	21.2	22.6	24.4	0.7	2.1	2.8	4.6	6.7
East Asia and Pacific	23.2	26.5	27.8	30.4	32.2	1.3	2.7	4.4	6.4	10.2
South Asia	10.8	9.9	10.9	13.5	17.0	0.8	1.3	1.4	1.4	1.4
Latin America and Caribbean	18.1	17.5	17.0	16.2	14.6	4.8	4.6	4.4	7.0	8.5
Middle East and North Africa	50.7	25.4	34.9	29.4	37.8	–1.5	1.0	1.0	1.1	1.5
Sub-Saharan Africa	33.6	29.7	31.9	30.0	32.5	0.0	2.2	1.0	2.2	2.7
East Europe and Central Asia	– ^b	– ^b	14.0	17.2	13.7	0.0	0.0	0.2	3.1	7.4

^aProjected. — ^bNot reported because of unreliable GNP data.

Source: World Bank (1994b).

earlier erosion of the region's attractiveness for FDI has been reversed in the early 1990s. This suggests that locations in Latin America resumed their role in the sourcing and marketing strategies of TNCs as a result of macroeconomic stabilization and liberalization becoming firmly rooted in major host countries. The renewed interest of foreign investors in the region offers favorable prospects for closer integration into world trade as well, considering that FDI and trade flows are typically positively correlated (Nunnenkamp et al. 1994). Likewise, the soaring FDI-to-export ratio in East Europe and Central Asia in the early 1990s supports the proposition that late-comers may join the ranks and participate in globalization, once deliberate isolation is replaced by world-market-oriented economic policies.

East Asia's outstanding position among DCs in terms of attractiveness for foreign capital is also reflected by the development of net resource inflows and changes in their structure (Figure 2).¹⁵ The share of this region in total net resource flows to all DCs grew from 15 percent in 1980 to 40 percent in 1994 (World Bank 1994b). The relative gain in attractiveness was largely at the expense of Latin America, whose share in total net resource inflows went down from one third in 1980 to less than one fifth in 1994. However, the comparison of these two years may lead to wrong conclusions with regard to this region's attractiveness for foreign capital, unless developments in the interim are taken into account. Net resource flows to Latin America dwindled to about US\$8 billion in 1989, but recovered quickly thereafter. In 1993/94, they averaged US\$53 billion, i.e., nearly 180 percent of inflows in 1980.

As concerns the structure of net resource inflows, various DC groups have in common that debt inflows, which had accounted for the bulk of total inflows in 1980, lost dramatically in importance. If this shift were to be attributed to the debt crises in Latin America and Africa exclusively, it should have been less pronounced for regions without serious debt problems such as East Asia. This is not the case, however. In both Latin America and East Asia, FDI and flows of portfolio equity accounted for two

thirds of total net resource inflows in 1994. It appears, therefore, that structural changes in the external financing of many DCs are associated with changes in the behavior of foreign investors under conditions of globalization and with a less restrictive attitude of host countries towards inflows of equity capital. Yet, the situation of Sub-Saharan Africa indicates that liberalizing the inflow of equity capital is not sufficient to induce a shift from debt to equity capital.¹⁶ Rather, the dependence of this region on foreign grants has gained further momentum. The risk of being delinked from the globalization strategies of TNCs appears to be particularly high for those Sub-Saharan African economies in which investment conditions remain subject to political uncertainty and economic instability.¹⁷

As mentioned before, portfolio investment has accounted for a significant share of total net resource flows to many DCs since recently. This applies to the relatively advanced economies in Latin America and East Asia in the first place (see also Figure 3).¹⁸ The steep increase in portfolio investment, notably in the early 1990s, was rendered possible by the deregulation of domestic capital markets in many DCs.¹⁹ This allowed provided international investors, e.g., Western pension funds, to diversify risks and derive profits in newly emerging capital markets. In contrast to FDI, however, the expanded engagement of portfolio investors beyond traditional markets is not directly linked to the globalization of production. While portfolio equity flows may be transformed into productive investment, they may be of a rather speculative nature and are easily withdrawn if higher returns are offered elsewhere or risk perceptions change abruptly (UNCTAD 1995b). Hence, portfolio investment trends to be more unstable than FDI. Its susceptibility to transient financial shocks is witnessed by the Mexican crisis of 1994/95. As a matter of fact, the phenomenal growth of portfolio equity flows was sharply interrupted in 1994 (Figure 3). While the reduction remained marginal in East Asia (-3 percent), inflows in Latin America were down to 42 percent of the figures for 1993.

Figure 2 – Structure of Capital Inflows,^a 1980 and 1994

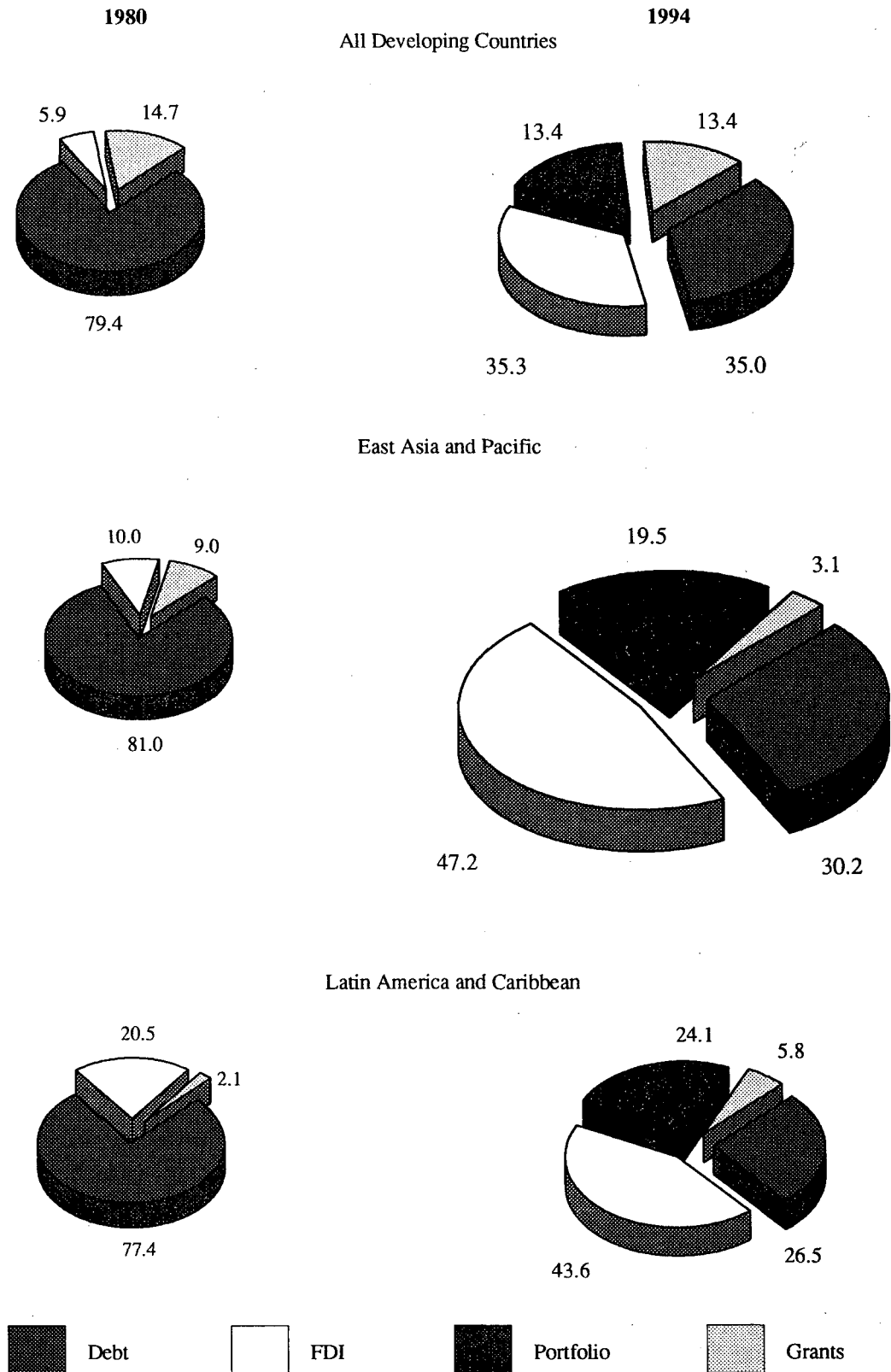
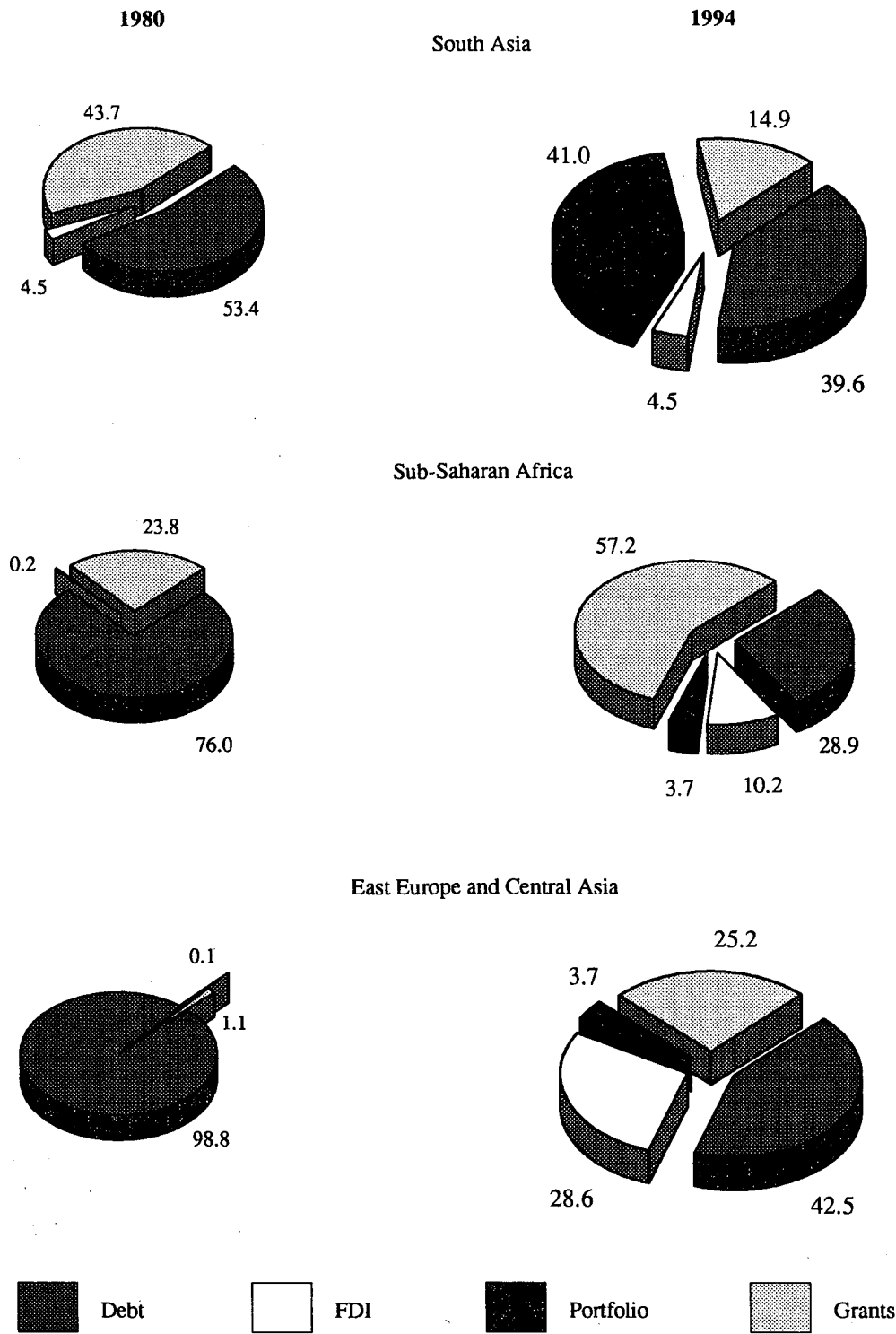


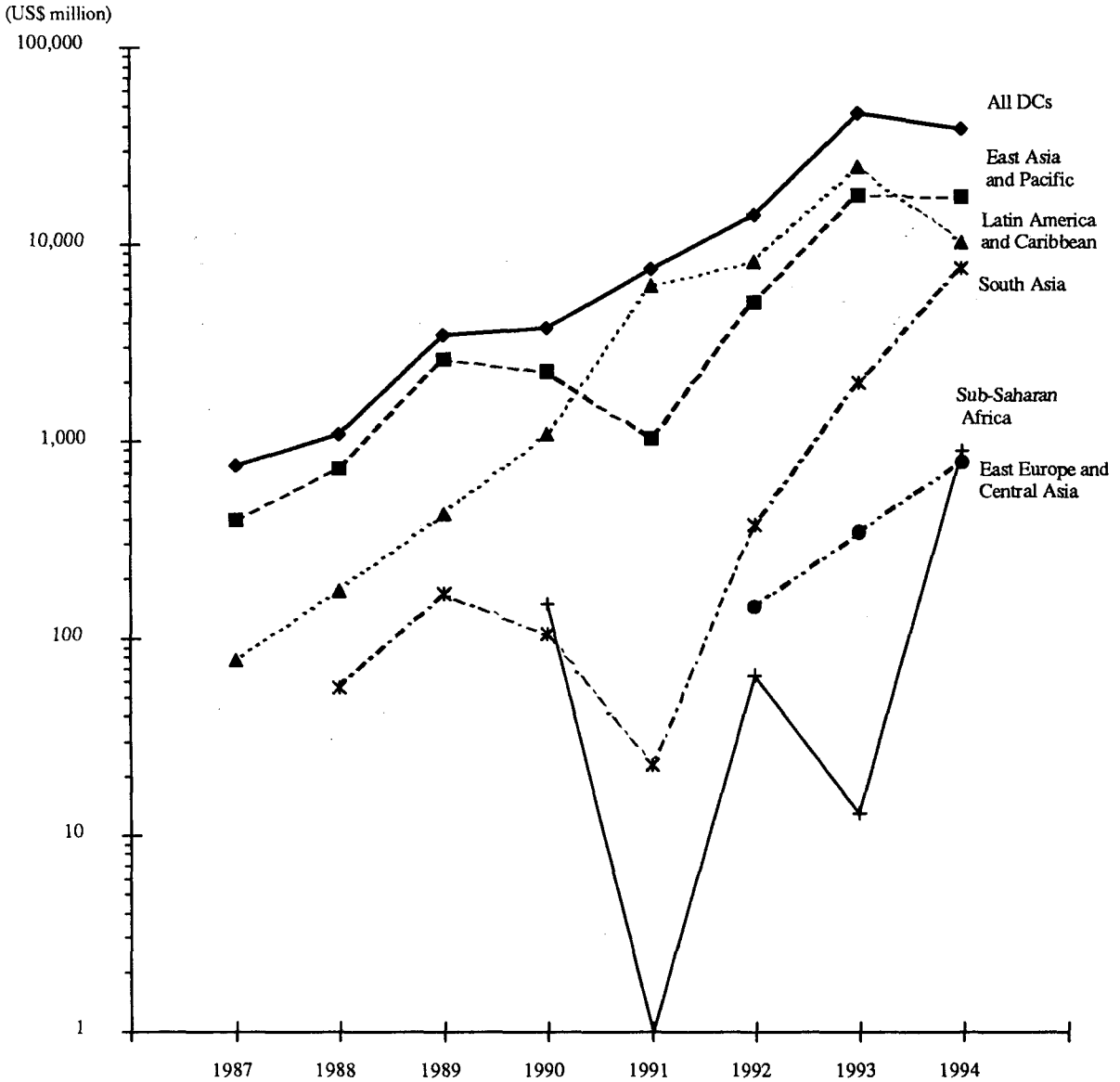
Figure 2 continued



^aPercent of total net resource inflows. Debt refers to net flows of long-term debt. Figures for 1994 are World Bank projections. Middle East and North Africa not considered because of negative (net) FDI inflows in 1980.

Source: World Bank (1994b).

Figure 3 – Portfolio Investment in Developing Countries, 1987–1994



Source: World Bank (1994b).

Yet, the growth of FDI in Latin America continued in 1994.²⁰ This supports the view that FDI is less volatile than portfolio investment and involves a lasting commitment to the recipient economy (UNCTAD 1995b: 3). Among the various elements of foreign capital inflows, FDI therefore provides the best indicator on the position of DCs in the globalization strategies of TNCs.

DCs as a whole have recently made considerable progress in getting involved in globalization

through FDI. According to UNCTAD data (1995a; 1995b), their share in worldwide FDI inflows averaged 32.3 percent in 1991–1993. In 1993 and 1994, respectively, this share reached 39 percent, which was nearly twice the average figure for the 1980–1990 period. The result of the FDI boom was that the ratio of FDI inflows to gross domestic capital formation increased from about 2 percent in the mid-1980s to 4.9 percent in 1992 (UNCTAD 1995b: Table 2).²¹

Again, however, a regionally disaggregated presentation reveals significant differences between major DC groups. In West Asia, the extremely low ratio of FDI inflows to gross domestic capital formation has remained more or less constant at about 0.5 percent. By contrast, the ratio has increased by 4 percentage points in East, South and Southeast Asia since 1985 (to 5.5 percent in 1992).²² Other DC regions, notably Africa and Latin America, range between these two extremes, in terms of both the level and the increase in the ratio. This underscores the above contention that the integration into the world economy has progressed most rapidly in many Asian DCs.²³

Related to this are significant changes in the regional distribution of FDI flows to DCs (Figure 4). East Asia's share has nearly quadrupled since 1980. This rise is mainly due to the P.R. of China's emergence on world capital markets.²⁴ TNCs have seized the opportunity to benefit from low-cost sourcing and the huge market potential, once China's integration into their globalization strategies was rendered possible by domestic liberalization. This does not imply, however, that neighboring DCs have been negatively affected. Rather, the contrary is true. FDI flows to East Asian DCs other than the P.R. of China increased by a factor of 8 from 1980 to 1993. Moreover, Chinese liberalization has also encouraged Asian TNCs, to globalize their production and marketing. As a matter of fact, the four Asian NIEs (Hong Kong, Singapore, South Korea and Taiwan) accounted for more than three quarters of FDI stocks in the P.R. of China by mid-1993 (UNCTAD 1995a: Table 4; see also below).

East Europe and Central Asia is the second region that has increased its share in total FDI flows. This recent development is obviously related to the progress achieved in economic transformation, notably in transition economies in East Central Europe. Latin America appears to be the main loser.

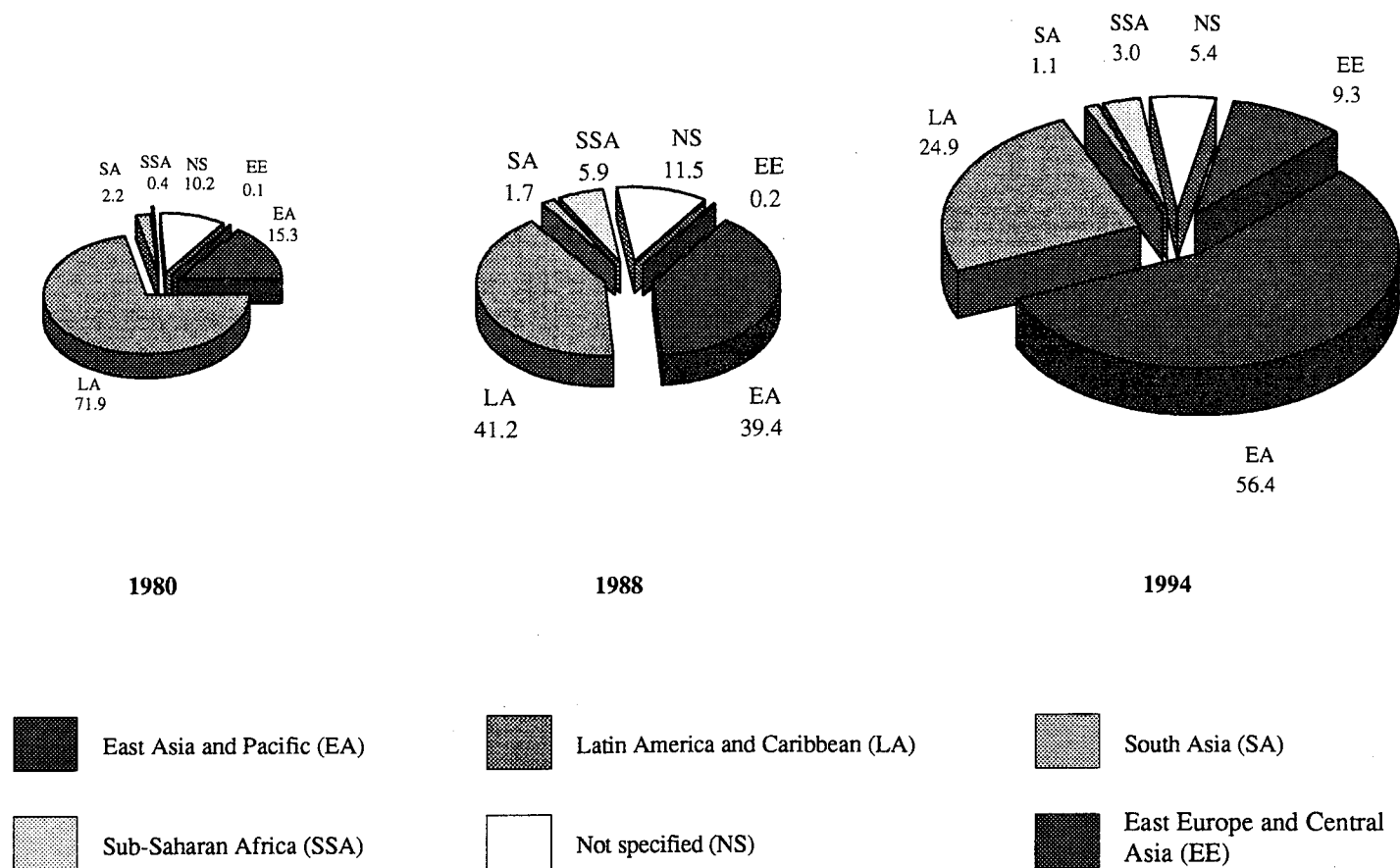
However, the regional share in total FDI flows tends to obscure factors relevant for assessing the position of Latin American economies in the context of globalization. *First*, the earlier stagnation of FDI inflows came to an end

in the late 1980s. The projected figure of US\$19 billion for 1994 exceeded the inflows in 1987 by a factor of 3.3 (World Bank 1994b). *Second*, several DCs in this region were among the best performers when FDI inflows in 1993 are compared to 1984.²⁵ The top five DCs in terms of this ratio include Argentina, Mexico and Chile (as well as the P.R. of China and Morocco). Particularly the favorable position of Argentina and Mexico indicates that attractiveness for FDI may be regained in the aftermath of major economic crises, once consistent domestic policy reforms (comprising macroeconomic stabilization and structural adjustment) are implemented. The counterfactual is provided by a country such as Brazil: this less reform-minded country lost its top position with regard to FDI inflows in 1984, and was surpassed by 10 of the 25 DCs under consideration.²⁶

Overall, the evidence for major DC recipients of FDI in 1984 puts into perspective the widespread belief that only few DCs may benefit from globalization. Underlying this belief is the observation that between two thirds and three fourths of total FDI flows to DCs have consistently been absorbed by the ten largest host economies (see, e.g., UNCTAD 1995: 9). Frequently it is not taken into account, however, that the country composition of the group of best performers changes over time. The top ten of 1984 experienced a considerable decline in their share in total FDI flows until 1993 (from 77.2 to 62.6 percent),²⁷ since new investment locations were becoming more attractive. The notion of persistently high concentration of FDI in DCs thus tends to underrate the chance of newcomers to enhance their locational attractiveness for foreign investors.

The chance of newcomers to participate in globalization has been further improved since recently. Some relatively advanced DCs, which had originally been only recipients of FDI, have become increasingly involved in outward FDI.²⁸ Their overall contribution to worldwide FDI outflows is still fairly low (Table 4). However, they are playing an important role as foreign investors in specific recipient countries, notably in less advanced neighboring economies. The so-called flying-geese pattern of East and Southeast

Figure 4 – Regional Distribution of FDI Flows to DCs,^a 1980–1994 (percent)



^aPercentage share in FDI flows to DCs other than in the Middle East and North Africa; this region is excluded because of significantly negative (net) FDI flows in 1980. Data on Hong Kong, Singapore and Taiwan are not reported in the source. Figures for 1994 are World Bank projections.

Source: World Bank (1994b).

Table 4 – FDI Originating from DCs,^a 1980–1993 (per cent)

	1980	1987	1992	1993
	<i>Share in worldwide FDI outflows</i>			
All DCs	2.0	2.2	5.6	4.3
	<i>Share in all DCs' FDI outflows</i>			
Selected DC regions				
Africa ^b	4.2	1.8	1.3	1.1
Asia	14.9	64.4	74.0	52.7
Europe	2.9	0.6	0.5	0.7
Middle East	40.8	26.5	16.7	20.5
Western Hemisphere	37.1	6.8	7.6	25.0

^aSome DCs which are well-known for investing abroad do not report official statistics on FDI outflows. India, Indonesia, Hong Kong and Malaysia are cases in point. Moreover, the source does not provide data on Taiwan. Hence, the share of DCs in worldwide FDI outflows and Asia's share in all DCs' FDI outflows are likely to be underestimated. Figures for 1993 are not fully comparable with previous figures due to incomplete data (figures for the P.R. of China and Thailand, for example, are not available). —
^bSouth Africa excluded.

Source: IMF *Balance of Payments Statistics Yearbook* (various issues).

Asian FDI is the most relevant case in point. In addition to their strong engagement in the P.R. of China, Asian NIEs (among which Hong Kong was the frontrunner) have invested significantly in medium-income ASEAN countries.²⁹ At the same time, the latter have undertaken investments in lower-income countries such as the P.R. of China and Vietnam.

D. Selected Case Studies

For several reasons, the globalization of production and its implications for DCs are likely to differ between various manufacturing industries. *First*, the degree to which production can be globalized depends on industry-specific characteristics. Globalization should be most advanced in industries which lend themselves easily for fragmentation of production processes, or for which production in the various final markets is essential for successful marketing. Globalization may be less advanced in industries characterized by closely intertwined stages of the production process (e.g., feedbacks from production to research and development) and large economies of scale. *Second*, the countries benefiting from globalization may vary from industry to industry. Notably the implications for DCs will depend on

The Asian pattern is basically driven by industrial restructuring going along with rising per capita income and wages.³⁰ The relatively advanced source countries are shifting towards more sophisticated lines of production, while relocating labor-intensive activities to lower-income economies. Similar to Japanese FDI in Asia, most of the NIEs' engagement is export-oriented. FDI thus facilitates moving up the ladder of comparative advantage in the source countries and, at the same time, offers opportunities for catching-up in the recipient countries. As a result, both country groups are better prepared to benefit from the worldwide trend towards globalized production.

As compared with Asia, intraregional networking appears to be less advanced in Latin America.³¹ In 1992, reported FDI flows between Latin American economies were largely restricted to Brazilian and Chilean engagements in Argentina. Yet, the higher share of this region in total FDI outflows from DCs in 1993 (Table 4) suggests that Latin America, too, may enhance its integration into the international division of labor by strengthening investment linkages.

whether their endowment with production factors conforms with the specific demands of a particular industry. *Third*, the mode of globalization is unlikely to be the same across industries. If internalization incentives are strong, FDI will be the preferred means. NEC may prevail in more standardized manufacturing activities (see Chapter B).

The subsequent sector studies will capture such differences at least tentatively:

- Textiles and clothing provide an example for a highly competitive and labor-intensive industry, in which non-equity forms of globalization have a long tradition.

- Chemicals stand for a physical-capital-intensive industry that has been among the front-runners of globalization by means of FDI.
- The production of automobiles represents a technologically more advanced and human-capital-intensive sector, in which new competitors from DCs have emerged recently.

The sector studies present some indications on the overall degree of globalization achieved, and then proceed to analyzing the implications for DCs. The industry-specific position of DCs is assessed by raising the following questions. *First*, has production been shifted towards DCs and which regions have benefited from relocation? *Second*, to which extent have DCs penetrated developed country markets and from where have new competitive world market suppliers emerged? *Third*, to which extent have FDI and other means of production sharing been used to integrate DCs into globalization strategies? Definite answers to these questions are sometimes difficult to achieve because of data constraints, however. For example, the statistical base is deficient as concerns industry-specific FDI flows to various DC groups. Based on various sources, a general pattern can nevertheless be identified.

I. Textiles and Clothing

Among the three sectors under consideration, textiles and clothing appear to be best suited for globalization, and DCs are most likely to benefit. Labor intensity is relatively high, which explains why many DCs started industrialization in this sector. Moreover, different stages of the production process have their specific technological and organizational characteristics. This encourages a division of labor by means of international fragmentation of production.³² Yet, globalization may have been retarded because the sector has been subject to intense political interference since decades, notably under the Multi-Fibre Arrangement (MFA).

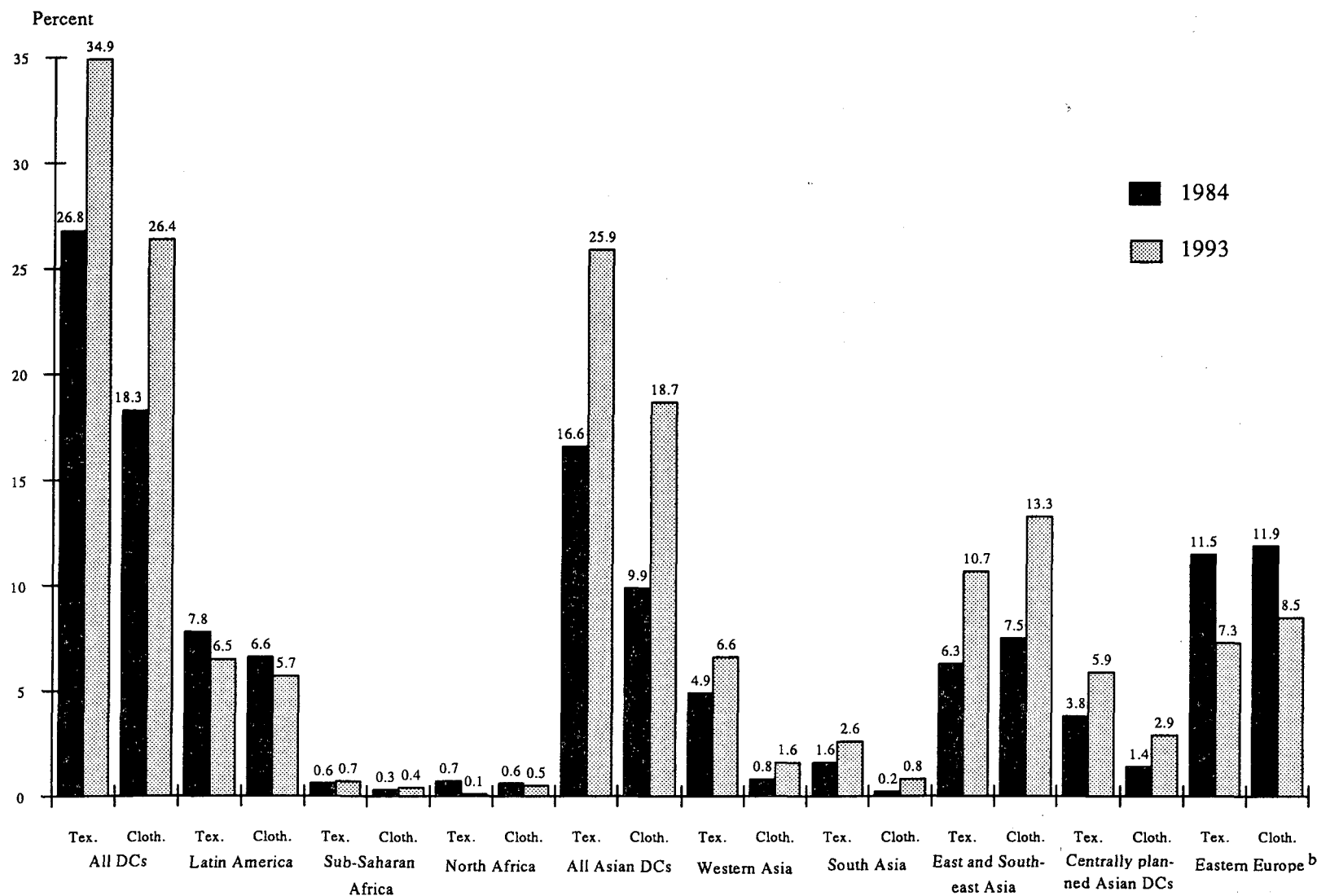
Indications are that policy interventions by developed countries did not halt globalization:

- World exports of textiles and clothing (SITC categories 65 and 84) grew by a factor of 2.7 between 1980 and 1992. This was significantly above the respective figure for world exports of all categories (1.8).³³
- The textile, clothing and footwear industry belongs to the top group of OECD industries with regard to international sourcing (OECD 1994a: 18, Table 18). The ratio of imported to domestic sourcing of inputs in this industry reveals a rising trend for all major industrialized countries since the early 1970s.
- In textiles and clothing, FDI has traditionally played a minor role, as compared to other manufacturing sectors. However, the sector's share in total manufacturing FDI outflows of France, Japan and the US increased from 1.1 percent in 1983–1985 to 2.9 percent in 1990–1992 (OECD 1994b).³⁴ At the same time, the ratio of FDI outflows to exports of textiles and clothing of these countries went up from 0.5 to 3 percent.³⁵ FDI thus expanded more rapidly than exports, which is consistent with the globalization hypothesis. Moreover, as will be shown below, NEC figures prominently in textiles and clothing.

In contrast to automobile and chemical production, textiles and clothing are among the geographically most dispersed manufacturing industries. Taken together, DCs accounted for 35 percent of world textile production (ISIC 321) and 26.4 percent of world clothing production (ISIC 322) in 1993.³⁶ DCs expanded their share in world production of both industries by more than 8 percentage points after 1984 (Figure 5). Many DCs, though not all, participated in this favorable development. Asian DCs contributed more than 70 percent to all DCs' textile and clothing production. Moreover, the increase of production shares was most impressive for this region. The group of East and Southeast Asian economies was particularly successful in gaining production shares. However, all other country groups within the Asian region, too, attracted higher shares in world production of textiles and clothing.

The picture is more ambiguous elsewhere. Among the regions considered in Figure 5, dramatically declining production shares are repor-

Figure 5 — Share of DCs in World Production of Textiles and Clothing,^a 1984 and 1993



^aProduction represents deflated value added, converted to 1990 US dollars. Regional disaggregation according to UNIDO.— ^bIncluding the former USSR.

Source: UNIDO data base.

ted for Eastern Europe only. This decline is restricted to the recent past and can be attributed to the general output fall after the collapse of the socialist regime. Modestly declining production shares are shown for Latin America. While much of this decline was concentrated on the 1980s, the downward trend has still continued in recent years. This may suggest that economic policy reforms pay off with a considerable time lag only if the credibility of governments is seriously eroded because of previous policy failures. In this respect, an encouraging sign may be that Latin America returned to positive growth of production of textiles and clothing in the early 1990s (unpublished UNIDO data base). African DCs increased their production shares slightly. Most notably, Sub-Saharan Africa reported a higher production growth in clothing than all DCs taken together in 1983–1993 (6.3 versus 4.4 percent). Nevertheless, the overall contribution of African DCs to world production of textiles and clothing remained marginal.

International trade patterns strongly support that DCs benefited from globalized production of textiles and clothing. Indices of export specialization reveal that DCs have achieved international competitiveness in both textiles and clothing. A frequently used index relates the share of textiles and clothing in total DC exports to the share of world exports of these items in total world exports (see, e.g., OECD 1994a: 19). An index higher than 1 indicates a favorable performance of DC exporters of textiles and clothing by world standards. As a matter of fact, their index for textiles (SITC 65) rose from 0.94 in 1980 to 1.76 in 1992; for clothing (SITC 84), it increased from 1.37 to 2.36.³⁷ The higher level and the stronger (absolute) increase of the index for clothing reveals that many DCs have exploited their comparative advantage in this particularly labor-intensive segment. The calculated index figures even tend to understate the international competitiveness of DCs, because in contrast to OECD competitors, DC exporters of textiles and clothing were subject to restrictive MFA regulations.

Table 5 provides more detailed insights on which of the non-OECD exporters of textiles and clothing have benefited from globalization.

The criterion is whether and to which extent they succeeded to penetrate OECD markets for textiles and clothing.³⁸ In less labor-intensive production of textiles, the Far East alone (notably the P.R. of China, South Asia and ASEAN countries) accounted for the increase of the market share of non-OECD suppliers by 3 percentage points in 1983–1992. Given the different production characteristics in the two segments of the sector under consideration, it is not surprising that both the level and increase of the non-OECD market share is higher for clothing. Moreover, improved competitiveness is not restricted to one particular region in this case. Though from fairly low base levels, the market shares of Africa and Latin America nearly doubled. All major suppliers from these regions participated in this development.³⁹ This is in contrast to the Far East, for which the extremely high but stagnating market share obscures remarkable changes within the region.

Table 5 – Share of Non-OECD Origins in OECD Imports of Textiles and Clothing,^a 1983 and 1992 (percent)

	Textiles (SITC 65)		Clothing (SITC 84)	
	1983	1992	1983	1992
Total non-OECD	23.5	26.5	56.4	61.1
Europe (non-OECD)	2.0	2.2	5.0	5.2
Africa	1.3	1.1	2.0	3.9
Egypt	0.4	0.4	0.0	0.2
Morocco	0.3	0.2	0.5	1.4
Tunisia	0.2	0.1	1.1	1.4
Latin America	2.6	2.1	2.5	4.8
Brazil	1.5	0.9	0.2	0.3
Colombia	0.2	0.1	0.1	0.3
Mexico	0.4	0.6	0.6	1.0
Middle East	1.0	1.4	0.6	1.1
Far East	16.6	19.7	46.2	46.2
Asian NIEs ^b	6.6	5.9	33.9	18.0
China, P.R.	4.0	5.0	4.8	13.6
India	2.1	2.8	1.9	2.6
Pakistan	1.6	2.5	0.3	1.0
Indonesia	0.2	1.3	0.4	2.1
Thailand	0.7	1.0	0.9	2.0

^aCountries are selected according to their significance as exporters within the region under consideration; also included are countries for which changes in market shares are notable. — ^bHong Kong, Singapore, South Korea and Taiwan.

Source: OECD *Foreign Trade by Commodities, Series C* (various issues).

The sharply declining share of OECD imports of clothing from Asian NIEs may be partly due to discrimination within the MFA framework. However, the major reason seems to be that

these relatively advanced economies restructured their manufacturing sectors towards more sophisticated lines of production. Parallel to this shift in Asian NIEs, neighboring countries with lower per capita income emerged as most competitive suppliers of clothing on OECD markets. While this applies to the P.R. of China in the first place, South Asian and ASEAN exporters, too, reported rapidly rising market shares.⁴⁰

Successful restructuring within Asia is not only reflected by intraregional shifts in trade. What has been called the flying-geese pattern is also observable with regard to FDI in textiles and clothing. Indications to this effect include the following:⁴¹

- Hong Kong was the top supplier of clothing on OECD markets in 1983, and 11–12 percent of its inward FDI stock was still in textiles and clothing at that time. The city state then became the frontrunner in relocating production to neighboring lower-income DCs.⁴² This move received another push once the P.R. of China opened up to FDI (see also ADB 1990: 41).

- In 1992, textiles and clothing accounted for 2.4 percent of total FDI inflows into Taiwanese manufacturing, while the sector's share in FDI outflows of Taiwanese manufacturing was 21.6 percent. By contrast, (lower-income) Thailand did not report FDI outflows in textiles and clothing to any significant extent, whereas the sector's contribution to FDI inflows in manufacturing was still relatively high.

- In ASEAN countries, the earlier focus of FDI inflows on resource processing was subsequently replaced by a shift towards labor-intensive manufacturing. FDI in textiles and clothing figured prominently in this respect, and much of it originated from Asian NIEs.

- South Asia's involvement in intra-Asian networking remained relatively weak (Agarwal et al. 1995). The case of India suggests that this is at least partly due to restrictions imposed on FDI in labor-intensive manufacturing such as textiles and clothing. Lall (1993: 108f.), for example, argues that the upgrading of Indian clothing exports was retarded in this way. This may explain why India's share in OECD imports of clothing increased only modestly by

the standards of newly emerging Asian competitors (Table 5).

As mentioned before, outward FDI by OECD countries is small in textiles and clothing, relative to FDI in the manufacturing sector as a whole. Among major investor countries, the sector's share was highest in overseas FDI stocks held by Japan (4.8 percent of FDI stocks in manufacturing in 1992) (OECD 1994b). About two thirds of Japan's engagement was in Asian DCs (OECD 1994a: 21). Moreover, mainly Asian neighbors benefited from subcontracting with Japanese producers and trading companies (*sogo shosha*) (Dicken 1992; Oman 1989).

Yet, other DC regions became integrated into globalization strategies of TNCs as well. The Caribbean, Mexican and Colombian clothing industries attracted FDI from the US (OECD 1994a: 22). Likewise, Mediterranean countries (e.g., Morocco and Tunisia) were the target of FDI from the EU. More importantly, though, the degree to which DCs benefited from globalization of US and EU producers would be seriously understated if non-equity forms of production sharing were ignored (Nunnenkamp et al. 1994: 75f.). Contractual arrangements have been widely used for the production and delivery of finished products by independent DC suppliers. Major partners of EU producers include companies in Turkey, Hong Kong and, increasingly, the P.R. of China. Furthermore, subcontracting has played a significant role in offshore processing of clothing. The ensuing fragmentation of EU production has basically followed the pattern established by preferential trade arrangements. Accordingly, Mediterranean countries and the ACP group had the best chances to attract offshore processing activities.⁴³ With economic transformation proceeding, Central and Eastern Europe has become another attractive location for offshore processing.⁴⁴

All in all, DCs have participated successfully in globalized production of textiles and clothing, even though they were subject to restrictive MFA regulations. In all probability, their integration into the worldwide division of labor will be further enhanced as it has been agreed in the

Uruguay Round to re-integrate MFA trade into the GATT/WTO framework.

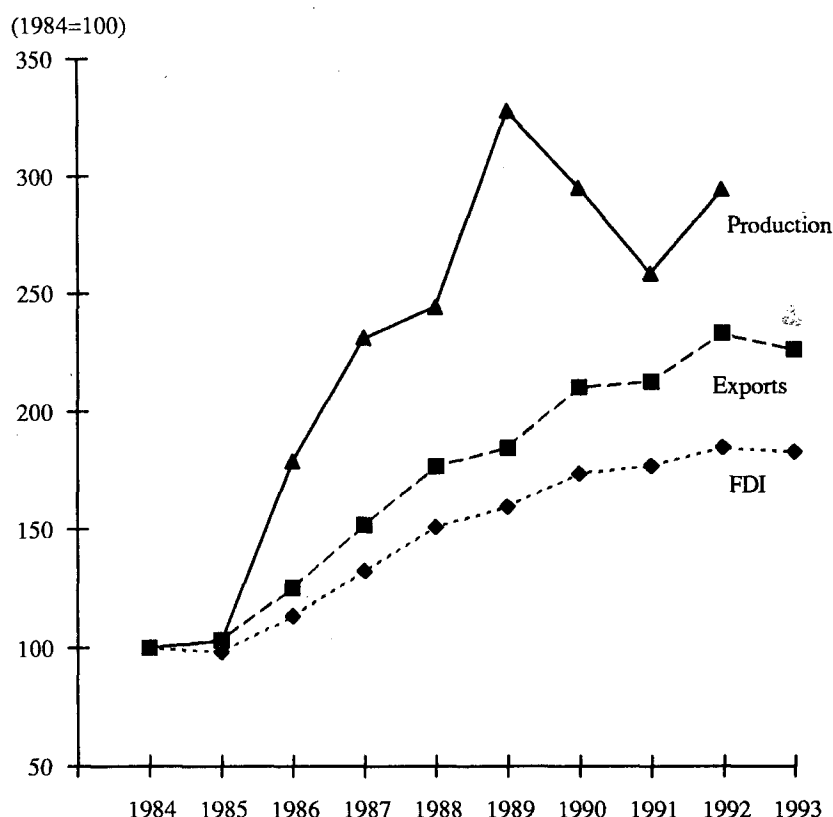
II. Chemicals

The chemical industry has been a frontrunner with regard to globalization. For major investor countries, it accounts for a substantial share of total overseas FDI stocks in manufacturing.⁴⁵ Also in terms of FDI outflows, globalization was more advanced than in the two other sectors analyzed in this study. FDI outflows in chemicals averaged 22 percent of outflows in all manufacturing industries by France, Germany, Japan, the UK and the US in 1990–1992 (OECD 1994b). The FDI-to-export ratio for the same group of countries and time period of about 7 percent exceeded the corresponding ratio for

both textiles/clothing and motor vehicles by far. Furthermore, Figure 6 reveals that chemicals conform perfectly to the predicted pattern of globalization, i.e., export growth surpassing production growth, and FDI growing even faster than exports.

Globalization in this physical-capital-intensive industry largely depends on the strategies of ten huge TNCs based in OECD countries. They accounted for 20 percent of world sales in 1988 (OECD 1992: 66). Recent merger and acquisition activities have probably added to concentration (Nunnenkamp et al. 1994: 67, Table A6). Nearly four fifths of worldwide turnover in chemicals were accounted for by OECD countries in 1993 (Verband der Chemischen Industrie 1994: 105). All this seems to suggest that globalization in the chemical industry is largely restricted to industrialized economies.

Figure 6 – Production, Exports and FDI Outflows of the Chemical Industry,^a 1984–1993



^aBased on data for EU countries, the US and Japan. FDI data are incomplete for the EU (notably Germany is not included). Production refers to turnover, exports to SITC 5.

Source: OECD (1994b), UN (1994b), Verband der Chemischen Industrie (1994).

However, non-OECD producers got increasingly involved in the chemical industry. The share of all DCs in world production ranged between 13 percent for plastic products and 18 percent for industrial chemicals in 1993 (Table 6). In the light of different factor intensities it is not surprising that the DC share remained lower in chemicals than in textiles and clothing. Nevertheless, both sectors have several things in common as concerns the role of DCs in globalized production. *First* of all, chemical production expanded overproportionally in DCs. The increase of the share of all DCs in world production was most pronounced for industrial chemicals.⁴⁶

Second, chemical production by DCs became increasingly concentrated on the Asian region. In the case of industrial chemicals, Asian DCs as a whole nearly doubled their share in world production, and their contribution to total DC production rose from 44 percent in 1984 to 70 percent in 1993. The group of East and Southeast Asian economies accounted for most of the increase of chemical production within Asia. Again, however, other Asian DCs became more important production locations as well. This refers in particular to (formerly) centrally planned economies in this region, whereas Western Asia benefited from shifts in worldwide production only in the case of industrial chemicals.

Third, Latin America hosted a larger share of worldwide production of industrial and other

chemicals than Asian DCs in 1984. As a production location for industrial chemicals, Latin America lost considerably in importance during the second half of the 1980s; the declining trend of the region's production share in this segment of the chemical industry was stopped only recently. Diverging developments occurred in other segments: Latin America's high share in world production of other chemicals remained virtually unchanged, whereas its role in the production of plastics continued to decline until 1993. Finally, chemical production in African DCs remained marginal as compared with all other DC regions. This was to be expected, considering the rather unfavorable position of African DCs even in industries which are better suited to their factor endowments than chemicals.

The world market performance of DCs in the chemical industry (SITC 5) underlines major findings revealed by production trends and provides some additional insights on the competitive position of these countries. The export specialization index (introduced in the previous section) reveals that DCs as a whole have improved their international competitiveness in chemicals. The share of SITC 5 in their total exports, relative to the share of world chemical exports in world total exports, more than doubled from an index figure of 0.25 in 1980 to 0.53 in 1992.⁴⁷ However, the index is still substantially below 1, indicating that DCs did not meet the world standard with regard to the weight of chemicals in overall trade. Accordingly, the share of all non-OECD suppliers in chemical imports of OECD countries is only a fraction of their import share in textiles and clothing (Tables 7 and 5). This is due to different factor intensities prevailing in these two sectors.

Against this background, it is not surprising that the number of DCs reporting rising shares in OECD imports of SITC 5 is smaller, notably as compared with clothing. More interestingly, though, the country composition of the group of most successful exporters differs between chemicals and clothing. In chemicals, mainly Asian NIEs made progress in penetrating OECD markets, i.e., exactly those economies reporting declining market shares in clothing. This supports the proposition that various DC groups at diffe-

Table 6 – Share of DCs in World Production of Chemicals,^a 1984 and 1993 (percent)

	Industrial chemicals (ISIC 351)		Other chemical products (ISIC 352)		Plastic products (ISIC 356)	
	1984	1993	1984	1993	1984	1993
All DCs	14.8	18.0	14.1	16.5	12.7	12.9
Latin America	7.6	4.6	7.6	7.9	4.9	3.3
Sub-Saharan Africa	0.1	0.1	0.3	0.3	0.2	0.2
North Africa	0.2	0.3	0.3	0.3	0.2	0.2
All Asian DCs	6.6	12.6	5.6	7.6	7.1	9.1
Western Asia	1.2	2.2	1.6	1.6	1.3	1.1
South Asia	0.7	1.0	0.7	0.9	0.1	0.3
East and Southeast Asia	2.2	5.2	2.1	3.6	4.5	5.9
Centrally planned Asian DCs	2.5	4.3	1.2	1.6	1.2	1.8
Eastern Europe ^b	5.8	4.0	2.5	1.6	1.4	0.8

^aProduction refers to deflated value added, converted to 1990 US dollars. Regional disaggregation according to UNIDO. — ^bIncluding the former USSR.

Source: UNIDO data base.

rent stages of economic development may benefit from globalization. The more advanced division of labor at a worldwide scale helped the relatively advanced DCs to upgrade their export structure. This in turn provided better chances for less advanced newcomers to enter world markets for more traditional, labor-intensive products, in which the frontrunners with regard to world market orientation were losing their comparative advantage.

Furthermore, Table 7 points to a highly diverse picture in different branches of the chemical sector:

- The share of non-OECD suppliers in OECD imports is lowest for pharmaceuticals. It is only in this branch that even Asian NIEs did not gain market shares in 1983–1992. Arguably, the pharmaceutical industry is most difficult for DCs to enter: It is highly concentrated and belongs to the most R&D-intensive manufacturing activities; product innovation is a crucially important competitive parameter (OECD 1992: 75ff.).

- For dyeing and related materials (SITC 53) and plastics (SITC 57 + 58), market shares of non-OECD suppliers are not much higher. In contrast to pharmaceuticals, however, OECD imports from non-OECD origins have increased overproportionally. With few exceptions (notably Argentina), this applies to all individual DCs considered in Table 7. Cases of considerable progress in penetrating OECD markets are largely the Middle and Far East; they include Asian NIEs and, in SITC 53, the P.R. of China and India.

- More than half of worldwide chemical production is accounted for by industrial chemicals, among which the relation between organic and inorganic chemicals is roughly 2 to 1 (OECD 1992: 65). For non-OECD sources as a whole, the increase of the market share for organic chemicals contrasts sharply with the decline (from a fairly high level) for inorganic chemicals. The latter is mainly due to the unfavorable performance of Africa.⁴⁸ DCs in other regions gained market shares (except Mexico), with the P.R. of

Table 7 – Share of Non-OECD Origins in OECD Imports of Chemicals,^a 1983 and 1992 (percent)

	All chemicals (SITC 5)		Organic chemicals (SITC 51)		Inorganic chemicals (SITC 52)		Dyeing mate- rials, etc. (SITC 53)		Pharma- ceuticals (SITC 54)		Plastics (SITC 57+58)	
	1983	1992	1983	1992	1983	1992	1983	1992	1983	1992	1983	1992
Total non-OECD	9.1	8.5	9.4	11.6	22.3	17.7	3.3	5.9	5.1	3.6	4.7	6.0
Europe (non-OECD)	2.8	2.1	2.8	2.0	6.9	5.7	0.5	0.7	0.8	0.6	1.9	1.6
Africa	1.6	0.6	0.5	0.3	8.6	3.4	0.6	0.3	0.2	0.0	0.1	0.1
Morocco	0.2	0.1	0.0	0.0	1.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
South Africa	0.6	0.2	0.1	0.1	3.9	1.4	0.6	0.3	0.1	0.0	0.1	0.0
Tunisia	0.2	0.1	0.0	0.0	0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Latin America	2.1	1.6	3.4	2.9	3.9	3.4	1.0	1.1	1.7	0.8	0.7	0.8
Argentina	0.2	0.1	0.4	0.2	0.0	0.1	0.5	0.4	0.1	0.2	0.2	0.0
Brazil	0.7	0.4	1.5	0.7	0.3	0.7	0.2	0.2	0.2	0.2	0.2	0.3
Mexico	0.5	0.5	0.4	0.8	1.8	1.3	0.2	0.4	0.3	0.2	0.3	0.4
Middle East	0.6	0.9	0.6	1.6	1.1	1.2	0.0	0.1	0.1	0.2	0.3	0.9
Far East	2.0	3.3	2.2	4.8	1.8	3.9	1.2	3.6	2.3	1.9	1.6	2.7
Asian NIEs ^b	0.9	1.6	1.1	2.7	0.5	0.8	0.7	1.7	1.0	0.5	1.5	2.4
China, P.R.	0.7	1.0	0.8	1.1	1.2	2.8	0.2	0.6	1.0	1.2	0.1	0.1
India	0.1	0.3	0.1	0.4	0.0	0.1	0.3	1.1	0.1	0.2	0.0	0.0
Malaysia	0.1	0.2	0.0	0.2	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Thailand	0.1	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.1

^aCountries are selected according to their significance as exporters within the region under consideration; also included are countries for which changes in market shares are notable. — ^bHong Kong, Singapore, South Korea and Taiwan.

Source: OECD *Foreign Trade by Commodities, Series C* (various issues).

China as the best performer by far. The same is true for organic chemicals, which are generally based on petroleum and natural gas; the notable exception in this branch is Brazil, whereas Asian NIEs performed best.

All in all, the OECD's import structure confirms that progress in entering world chemical markets was concentrated on Far Eastern economies. This development was not restricted to Asian NIEs, however, but included lower-income countries such as the P.R. of China and India in different segments of the chemical sector.

OECD-based TNCs are estimated to account for about a quarter of DC production of chemicals (OECD 1992: 68). This indicates already that FDI has supported the integration of emerging chemical producers into the international division of labor. The distribution of overseas FDI stocks held by the chemical industry of major investor countries reveals some interesting features in this respect (Table 8). The counterpart to Africa's poor world market performance was its failure to attract FDI to any significant extent. Latin American DCs (especially Brazil and Mexico) hosted more than 70 percent of German and US FDI in the chemical sector of non-OECD countries in the early 1990s. Asian DCs were largely ignored by German investors.⁴⁹ Among Asian DCs, which hosted about one third of US FDI stocks, the group of four NIEs received the greatest attention of US investors. By contrast, Indonesia was the most important recipient of Japanese FDI. Generally it appears that the integration of Asian DCs into world chemical markets was fostered by relocation of Japanese production in the first place (see also OECD 1992: 72).⁵⁰ Asia's share in total chemical FDI stocks of Japan was five times as large as for US FDI (and exceeded the corresponding share in German FDI by a factor of 16).

The role of FDI in stimulating chemical production in DCs is underscored by the prominence of this sector in total FDI inflows of major host DCs in the late 1980s and early 1990s.⁵¹ For four out of seven host countries (Argentina, Mexico, South Korea, and Taiwan), the chemical industry accounted for 23–26 percent of total

Table 8 – FDI Stocks in Chemicals Held by Germany, Japan and the US in DCs (percent of total FDI stocks in chemicals of the respective source country)

	Germany ^a (1992 stocks)	Japan ^b (cumulative flows 1951– 1992)	US ^c (1993 stocks)
African DCs	0.1	0.2	n.a.
Latin America	9.3	6.0	13.9
Argentina	1.0	n.a.	1.0
Brazil	4.0	2.3	4.6
Chile	n.a.	n.a.	0.3
Colombia	n.a.	n.a.	0.6
Mexico	3.1	n.a.	5.2
Venezuela	n.a.	n.a.	0.6
Asian DCs	1.8	29.4	5.8
China, P.R.	n.a.	0.6	0.1
Hong Kong	n.a.	0.2	0.3
Singapore	n.a.	5.9	1.1
South Korea	0.5	3.3	0.5
Taiwan	n.a.	n.a.	1.7
India	0.3	n.a.	0.3
Indonesia	n.a.	10.6	0.1
Malaysia	0.4	3.0	0.1
Philippines	n.a.	n.a.	0.8
Thailand	n.a.	2.0	0.5
Middle East	n.a.	8.1	n.a.
OPEC	0.6	n.a.	n.a.
Central and Eastern Europe	0.8	n.a.	0.1
Total	12.6	43.7	19.7

^aOPEC countries are not included in DC regions. Central and Eastern Europe includes formerly centrally planned economies in Asia (notably the P.R. of China). Total represents the sum of all DCs, as given in the source, OPEC and Central and Eastern Europe. — ^bOPEC countries are included in the respective regions. Middle East is not included in Asian DCs. Total: sum of African DCs, Latin America, Asian DCs and Middle East. — ^cOPEC countries are included in the respective regions. Asian DCs: Asia and Pacific, as given in the source, minus Australia, Japan and New Zealand. Total: sum of Latin America, Asian DCs and Central and Eastern Europe.

Source: Deutsche Bundesbank (1994), Ministry of Finance (1993), US Department of Commerce (1994).

FDI inflows in manufacturing. Among manufacturing industries, chemicals ranked first (South Korea) or second, only surpassed by motor vehicles in Argentina and Mexico, and by electric and electronic equipment in Taiwan. The contribution of chemicals to overall FDI inflows in manufacturing ranged between 10–14 percent in Malaysia, Singapore and Thailand. Still, it ranked second (behind electric and electronic equipment) in the latter two countries.

In addition to FDI, international linkages have been established through NEC.⁵² In a number of cases, TNCs have participated in establishing petrochemical plants in DCs through technical cooperation agreements, turnkey projects, management and marketing contracts, and licensing. Examples include: Argentina, Brazil and Mexico

in Latin America, and India, the P.R. of China, South Korea, Taiwan and ASEAN countries in the Far East (Ward 1992: 7; Oman 1989). Pharmaceuticals and other chemicals accounted for nearly one third of all non-equity investments in Bangladesh during the 1980s (Reza 1992). Franchising has increasingly been used as a flexible instrument of globalization in countries where business risks and bureaucratic hurdles are still high (e.g., in Central and Eastern Europe).

In summary, globalization in the chemical industry has gone beyond fierce competition among OECD suppliers since recently. The Triad of the EU, Japan and the US will continue to dominate this sector for the time being. However, the evidence presented above supports earlier forecasts that the Asian-Pacific region has the best chances to expand production and exports of chemicals (UNIDO 1990: 187). High growth projections for Asian chemical markets are fuelling FDI inflows into this region. The integration of newly emerging producers of chemicals into the international division of labor may gain further momentum once uncertainty of foreign investors due to insufficient protection of intellectual property rights is reduced.⁵³ The recent agreement on trade-related intellectual property rights (TRIPs) during the Uruguay Round represents a major step in this direction.

III. Motor Vehicles

Among manufacturing industries, motor vehicles rank third in terms of FDI stocks held abroad by the US and Germany in 1992 (OECD 1994b).⁵⁴ FDI outflows originating from these two countries averaged 3.5 percent of motor vehicle exports in 1990–1992.⁵⁵ This ratio was lower than in chemicals, but substantially above the FDI-to-export ratio in the textile and clothing industries of the US and Germany. Furthermore, the US ratio increased from 2.2 percent in 1983–1985 to 5.2 percent in 1990–1992 (German data are not available). All this suggests that globalization prevails in the manufacturing of motor vehicles as well.

Yet, among the three sectors analyzed in this study, it may be most difficult for DCs to participate in globalized production of motor vehicles. This sector applies relatively advanced technologies and is, thus, fairly demanding in terms of human skills. As a matter of fact, few DCs have emerged so far as important producers of motor vehicles (Table 9).⁵⁶ Their share in worldwide production has increased significantly, however. Within a decade, production soared nearly eightfold in South Korea and surpassed 2 million units in 1993. In the P.R. of China and Mexico, production expanded by a factor of 3.7 and 3.0, respectively. As a result, earlier projections on production shares of non-OECD suppliers were considerably exceeded.⁵⁷ The discrepancy between actual and hypothesized production shares is likely to increase further. The group of newly emerging suppliers of motor vehicles will be enlarged, as soon as Western engagements in the automobile sectors of transition economies in Central Europe result in increased production in this region.

The regional distribution of production of autotoparts is more difficult to assess, because com-

Table 9 – Production of Motor Vehicles by Major Non-OECD Suppliers, 1984 and 1993 (percent of worldwide production)

	1984	1993
Central and Eastern Europe		
Czechoslovakia (former)	0.5	0.5
Hungary	0.0	0.1
Poland	0.8	0.6
Romania	0.3	0.2
Soviet Union (former)	5.2	3.4
Yugoslavia ^a (former)	0.6	0.0
Latin America		
Argentina ^a	0.4	0.7
Brazil	2.0	3.0
Mexico	0.8	2.3
Asia		
China, P.R.	0.7	2.5
India	0.4	0.8
South Korea	0.6	4.4
South Africa ^a	0.6	0.6
All 13 countries ^b	13.3	19.1

^aSignificant assembly activities included. — ^bDifferences due to rounding.

Source: VDA (various issues).

parable statistics are largely lacking. Until the late 1980s, parts production was concentrated on OECD countries at least as strongly as automobile production. According to estimates by the OECD (1992: 35), it was only South Korea and Taiwan which recorded a noteworthy — and rising — production of autoparts. Selected empirical evidence from various sources suggests, however, that non-OECD suppliers have increased their share in parts production recently: *First*, major DC producers of motor vehicles have achieved a very high local parts content (OECD 1992: 52f.). In South Korea, nearly 90 percent of automotive inputs used by national assemblers were supplied by domestic firms. Local content is well over 80 percent in Brazil and Argentina, and in the range of 60–70 percent in Mexico. Taiwan attempted to develop a largely self-sufficient automobile industry by the 1990s, while ASEAN countries promoted parts production at the regional level.⁵⁸ *Second*, UN data suggest that more than 17 percent of worldwide production of motor vehicle engines (ISIC code 3843-04A) originated from Mexico and South Korea in 1992; five years earlier, the share of these two countries had been 11.3 percent (UN 1994a: 824).⁵⁹ *Third*, some DCs have attracted offshore autoparts production by OECD firms. Significant US and Japanese investment in Mexico's duty-free zones is a case in point (OECD 1992: 53). Likewise, US car manufacturers operating in Brazil export parts back to the US. Brazil's integration into the globalization strategies of automobile TNCs is reflected by a particularly high share of exports of automotive inputs (including chassis, bodies, parts and accessories) in its total automotive exports (38 percent in 1992) (VDA 1994: 333).⁶⁰ Also the rather indigenous Korean industry has started supplying autoparts to foreign car manufacturers (about 10 percent of its total autoparts production), mostly to Japan.⁶¹

The regional structure of OECD imports of road vehicles (SITC 78)⁶² supports major findings from the distribution of worldwide production (Table 10). OECD countries continued to dominate, and non-OECD competitors were still few. Yet, some of the newly emerging suppliers made considerable progress in penetrating

Table 10 – Share of Non-OECD Origins in OECD Imports of Road Vehicles (SITC 78),^a 1983 and 1992 (percent)

	1983	1992
Total non-OECD	2.1	5.5
Europe (non-OECD)	0.8	1.0
Africa ^b	0.1	0.1
Latin America	0.8	2.5
Brazil	0.3	0.3
Mexico	0.4	2.2
Middle East	0.0	0.0
Far East	0.5	1.9
China, P.R.	0.0	0.2
South Korea	0.1	0.7
Taiwan	0.4	0.8

^aCountries are selected according to their significance as exporters within the region under consideration; also included are countries for which changes in market shares are notable. — ^bIncluding South Africa, which almost exclusively accounts for African exports of SITC 78.

Source: OECD *Foreign Trade by Commodities* (various issues).

OECD markets. This applies to Mexico, South Korea and Taiwan in the first place. The parallel increase of domestic production and export market shares (except for Brazil) indicates that the motor vehicle industry of some relatively advanced DCs has become competitive by world market standards.

In most instances, this development was helped by drawing on Western skills and technology. FDI played the dominant role in Latin America's motor vehicle industry. This sector accounted for 27 percent of Mexico's FDI inflows in manufacturing in 1988–1992 (OECD 1994b: 161). The respective share amounted to 39 percent in Argentina (1990–1992), and 17 percent in Brazil (1983–1987) (OECD 1994c).⁶³ Latin America hosted nearly all German FDI stocks in the motor vehicle industry of DCs (DM 4.5 billion in 1992) (Deutsche Bundesbank 1994).⁶⁴ Also US FDI in the motor vehicle industry of DCs was heavily concentrated on this region (US Department of Commerce 1994: 137). The major motive underlying German and US investment was to penetrate large — and protected — markets of Latin American economies. Nevertheless, operations in Brazil

and Mexico were increasingly integrated into the global sourcing strategies of TNCs (notably of US companies).

As compared with Latin America, FDI played a less important role in the motor vehicle industries of Asian countries.⁶⁵ In South Korea, the sector's share in total FDI inflows in manufacturing amounted to 14 percent in 1989–1991 (OECD 1994c: 13). Nonetheless, the development of local automobile production has been supported considerably by establishing links with leading Western companies. Government policies in Asian DCs have gradually shifted from high protection of domestic automobile producers to a greater degree of global interaction, in order to encourage technology transfers from OECD countries (OECD 1992: 52f.):

- ASEAN countries concluded an agreement with Mitsubishi to help promoting the ASEAN car project.
- The Korean autoparts industry was built on the basis of licensing and other interfirm arrangements, mainly with Japanese companies.⁶⁶
- Recently, major EU automobile producers, too, entered into cooperation agreements and joint ventures with minor equity stakes in South Korea, Taiwan, India and, most notably, in the P.R. of China.⁶⁷

It may be difficult to predict the future shape of the world's motor vehicle industry, which will depend on the strategies of major OECD firms in the first place. Technological and organiza-

tional innovations, including lean production, flexible workshops and just-in-time delivery, may result in closer networking between input suppliers, car assemblers and customers at the regional level. If so, worldwide sourcing and export-oriented offshore production would become less important in determining international competitiveness of car manufacturers (Oman 1994). In any case, however, some new competitors from relatively advanced countries in the Far East, Latin America and Central Europe are well prepared to participate successfully in the future development of worldwide production of motor vehicles. First attempts to establish production facilities in the OECD, such as the assembly plant for the Korean car manufacturer Hyundai in Canada, are a clear indication to this effect.

Finally, the experience of Brazil and Mexico suggests that the chances of new competitors to benefit from globalization in this relatively sophisticated industry critically depend on domestic economic policies and the ensuing local investment climate. Probably, it is not by pure coincidence that Mexico has succeeded to improve both its attractiveness for FDI and its competitive position on automotive OECD markets, relative to Brazil. Rather, these developments seem to be related to comprehensive reform efforts in Mexico, and at best partial attempts at macroeconomic stabilization and structural adjustment in Brazil. This proposition is further elaborated in the next chapter.

E. The Future Position of DCs in Globalized Production

The previous chapters have demonstrated the different degree to which various DCs are participating in the globalization of production and markets. What makes up for these differences, and what are the determinants of becoming an attractive location for risk capital? Once the determinants are understood, it will be possible to draw some policy conclusions for those DCs that want to follow the way which was led by

many Asian DCs, especially during the past decade.

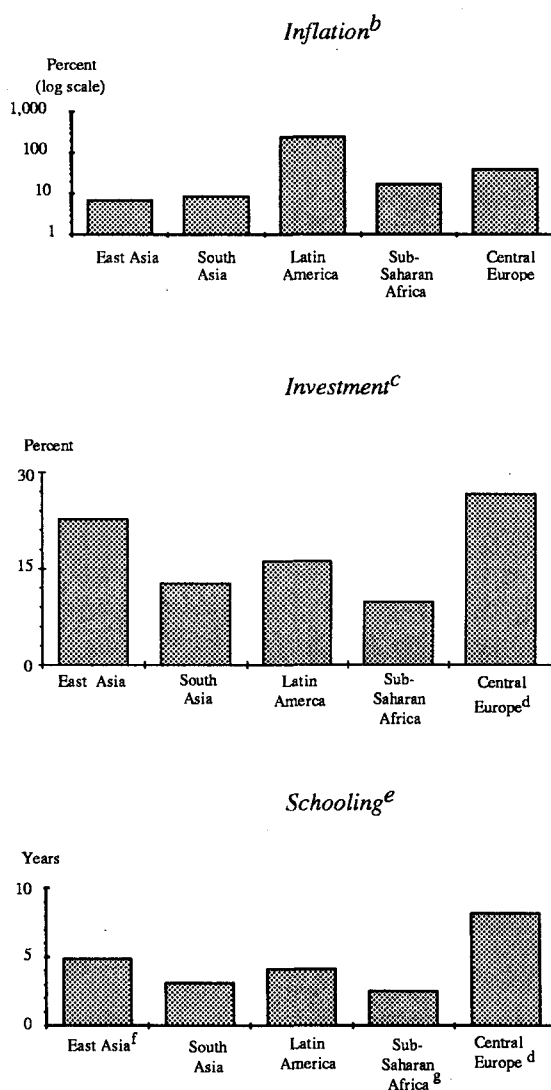
I. The Impact of Domestic Economic Policies

The major factors shaping the future position of DCs in globalized production concern the stance

of domestic economic policies with respect to macroeconomic stability, investment, and human capital formation. Figure 7 presents selected evidence as to why East Asia has been more successful than other groups of DCs⁶⁸ in attracting FDI and other forms of international business cooperation, and why it has become the new powerhouse of the world economy. The first indicator of a sound business environment is macroeconomic stability, namely the absence of high and volatile rates of inflation. High rates of inflation render it difficult for consumers and producers to identify changes in *relative* prices. The reduced informational content of observed price changes results in higher investment risks, and in a misallocation of resources. Inflation safe, though less productive investments will be preferred. Unexpected inflation may have a positive output effect in the short run by reducing real wages. However, money illusion is unlikely to prevail for long. Future wage demands will take into account the expected rate of inflation. Eventually, this process may end up in hyperinflation, output decline, soaring unemployment, and political chaos. Latin America has performed most unfavorably in this respect in the past, followed by Sub-Saharan Africa and Central Europe. In the latter, high rates of inflation largely reflect soft budget constraints of state-owned enterprises which have relied on government support for sustaining production and employment.

Persistent inflation is generally home-made, budget deficits of the government being the main reason. This is most obvious when deficits are financed by printing money. Alternatively, the higher the budget deficit, the higher have to be the taxes that producers and consumers have to pay. High business taxes impair the incentive to invest and, thereby, reduce productivity growth; high income taxes impair the incentive to work (except for work in the underground economy), and, thereby, further enforce the pressure to increase taxes. It follows that countries with large budget deficits and high rates of inflation are relatively unattractive locations for international investors, and cannot be expected to experience strong economic growth in the long run.

Figure 7 – Macroeconomic Indicators for DCs^a



East Asia: P.R. of China, Indonesia, South Korea, Philippines, Thailand; *South Asia:* Bangladesh, India, Nepal, Pakistan, Sri Lanka; *Latin America:* Argentina, Brazil, Chile, Colombia, Mexico; *Sub-Saharan Africa:* Cameroon, Côte d'Ivoire, Ghana, Kenya, Tanzania; *Central Europe:* Bulgaria, Hungary, Lithuania, Poland, Romania.

^aPopulation weighted averages. — ^bAnnual average, 1980–1992. — ^cIn percent of GDP, average for 1980–1992, in constant international prices. — ^dExcluding Lithuania. — ^eAverage years of schooling of the working age population, 1985. — ^fExcluding P.R. of China. — ^gExcluding Côte d'Ivoire.

Source: Barro and Lee (1993), Heston et al. (1994), World Bank (1994c).

Macroeconomic stability appears to be a necessary precondition for participation in globalization. In a stable macroeconomic environment, investment can be expected to be higher because risks are contained. More investment enlarges the stock of capital per worker, increases labor productivity, and produces higher incomes in the long-run. The second panel in Figure 7 indeed reveals that low-inflation East Asia displays an outstanding investment performance among DCs.⁶⁹ Yet, the case of Central Europe demonstrates that high investment does not guarantee successful economic development. In this region, centrally planned investment resulted in allocative distortions so that productivity growth remained sluggish until the regime shift. Moreover, physical capital accumulation is not all that matters. Human capital formation may be even more important as a driving force of economic growth. This is all the more so in the global economy, where the diffusion of new technologies is advanced by declining information and transaction costs. The lower panel in Figure 7, which presents average years of education as an indicator of human capital accumulation, supports this consideration at least partly: Among DCs, East Asia is again the best performing region. This indicator also suggests that Central Europe may face favorable prospects to become integrated into the globalization strategies of TNCs.

More systematic evidence for the hypothesis that formal education plays a leading role for an explanation of economic success comes from recent empirical cross-country studies (Barro 1991; Manki et al. 1992; Gundlach 1995). These studies uniformly confirm that human capital formation is at least as important as physical capital formation for explaining the large differences in per capita income between industrialized countries and DCs. They also support theoretical models which predict that economic backwardness is not necessarily a permanent state of affairs. Low-income countries have the chance to realize higher growth rates than rich countries, because they can use existing technologies rather than having to invent them. The predicted *and* estimated speed of convergence is fairly slow (2 percent per year or even

less), so that this “natural” catching-up process alone does not suffice to realize substantial improvements in the standard of living within reasonable periods of time. The East Asian example reveals, however, that there are ways to speed up convergence. Integration into the international division of labor appears to be crucially important in this respect.

Overall, East Asia’s success in becoming an attractive location for international businesses seems to be related to a combination of short- and long-run factors which can be shaped by domestic economic policies. Macroeconomic stability is a matter of government budget discipline, the rate of investment is a question of business conditions, and the amount of compulsory formal education reflects the government’s attitude towards the provision of public goods. A priori, there is no reason why Asian-type success stories should not happen in other parts of the world, say in Latin America or in Eastern Europe.

II. The Role of New Technologies

As concerns the future prospects of DCs to participate successfully in globalization, there is widespread agreement that continuous acquisition of technological and managerial know-how is a critical factor. Government policy plays a twofold role in facilitating technological progress (Agarwal et al. 1995). *First*, international trade and exchange rate policies affect many of the channels through which the transfer of foreign technologies may take place. *Second*, the successful application of new technologies depends on local technological capability, namely the ability to select, adapt, diffuse, and build upon imported technology. Local technological capability, in turn, is influenced by government policy in several areas, most prominently in education.

Different forms of technology transfer may be classified by the demands they make on the user’s technological capability and, correspondingly, on the intensity of the relationship between the supplier and the user of the transferred technology. One extreme is represented by FDI

in the form of turnkey plants where the new technology is not only supplied by, but also used under the direct control of the parent company. Initially at least, there may be little reliance on local inputs other than labor, and limited scope for technological learning. By contrast, technology licensing and the purchase of equipment embodying new technology involve more of an arm's length relationship between suppliers and users. The efficient use of these channels depends on the user's ability to obtain and process sufficient information to choose among available techniques, and to adapt the new technology to local conditions with only limited support from the supplier. This applies even more strongly to technological information obtained from customers, especially foreign importers, or from sources in the public domain.

Some observers fear that new manufacturing techniques will render it more difficult for DCs to attract foreign capital in the future. New technology encompasses innovations in hardware, such as new machinery, and software, such as organization, business administration, and marketing. To be successfully applied, these new technologies may require complementary human skills being in short supply in most DCs. Freeman and Hagedoorn (1994) argue that technological capabilities are extremely unevenly distributed in the world economy. About two thirds of worldwide R&D efforts take place within the Triad, whereas DCs only account for about 5 percent of global R&D (the rest is mainly military and aerospace R&D by the former Soviet bloc). A similar picture emerges for patents. According to this most frequently applied indicator, the combined share of DCs in global technological output would amount to about 1–3 percent. However, the minor overall role of DCs in technological development obscures different trends at the regional level. R&D expenditures of Asian NIEs were growing rapidly in the 1980s, and their patenting activities began to rise. This is in contrast to Latin American DCs, where no improvement could be identified (Freeman and Hagedoorn 1994). Moreover, the attractiveness of DCs for foreign capital primarily depends on their capabilities in *applying* existing technologies, rather than on their role in produc-

ing technological output. As was shown before, many DCs have made substantial progress in the former respect.

Another question is whether DCs actually receive technologies that fit their factor endowments. What can be expected in a globalizing economy is that NIEs should receive a higher share of advanced technologies than less advanced LDCs. Table 11 provides some empirical evidence derived from the MERIT data base with regard to the relative importance of so-called core technologies in (international) interfirm technology partnering. It is widely accepted that information technology, biotechnology, and new materials constitute the heart of many future technological developments affecting manufacturing, but also many services. Technology partnering within developed countries, and especially within the Triad, is dominated by these three core technologies. Core technologies account for about half of all partnerships between Triad and NIE companies, while two thirds of all partnerships involving LDCs are in areas other than core technologies. This pattern supports the view that the focus of technological cooperation is related to factor endowments of partners.

Table 11 – The Share of Core Technologies in International Interfirm Technology Partnering, 1980–1989 (percent)

	Share of core technologies ^a in:	
	Strategic technological alliances	Technology transfer agreements
Developed countries	73.0	60.9
Triad	73.5	61.4
Triad–NIEs	53.6	52.4
Triad–LDCs	23.4	38.5

^aInformation technology, biotechnology, new materials.

Source: Freeman and Hagedoorn (1994).

From the lower level of technological cooperation between industrialized countries and DCs it cannot be concluded that DCs do not have access to advanced technologies (see Section C.I). Rather, interfirm cooperation in high-tech sectors is a suboptimal means to transfer technology between partners at considerably different stages of economic development. Interfirm

agreements on technology cooperation are just one way of technology transfer. Alternative means appear to be more appropriate for DCs attempting to improve their technological capabilities. Other channels include arm's length types of NEC, imports of machinery and capital goods, and FDI by TNCs.

In some cases, the import of foreign technology by DCs has been complemented by autonomous domestic efforts to develop technology. The Taiwanese computer industry provides an example (San 1992). Notwithstanding the significant role of the Taiwanese computer industry on world markets, the majority of its constituent enterprises are small or of medium size. These SMEs have responded flexibly to market changes, but are largely incapable of developing advanced technologies on their own. Therefore, the major firms in this industry decided to form a so-called "technology development alliance" in 1989. The aim was to create specific computer chip technologies, which required the establishment of a microelectronic laboratory with high quality standards, and the engagement of more than 200 engineers and technicians. This project was initiated and directed by the government-sponsored Industrial Technology Research Institution, while the costs had to be shared by those firms interested in joining. In the case of Taiwan, joint efforts in developing new technology have spread to other industries as well, for instance to automobile manufacturing and consumer electronics.

Finally, a larger flow of technology through NEC to DCs in the 1980s was hindered by policy disincentives in DCs, rather than by a natural tendency for technology concentration in industrialized countries. Some support for this proposition may be derived from a survey of enterprises which engage in licensing their technology internationally (Vickery 1988).⁷⁰ One half of all respondents reported that government regulations, foreign exchange controls, and inadequate industrial-property-rights protection had prevented agreements from being reached; three quarters mentioned that they had caused undue delays.⁷¹ Enterprises engaged in licensing are typically involved in other kinds of technology transfer activities at the same time, such as

joint ventures, sales of technology, and technical service contracts.⁷² This suggests that the same policy-induced obstacles which hindered technology flows through licensing are responsible for limited technology flows in other areas of NEC.

III. Regionalization, Globalization, and Convergence

Some authors claim that there is no general trend towards globalization involving DCs. They argue that a tendency towards regional production and sourcing networks will impair the chances of DCs to benefit from technology transfers (Oman 1994). This would imply that DCs face the risk of being excluded from the growth dynamics of globalization if they do not join regional groupings. The empirical evidence presented above does not support this view. While regional networking does play an important role with respect to both NEC and FDI, Chapters C and D clearly show that global networking, too, is on the rise. Furthermore, the fact that not all DCs have participated in globalization so far cannot be attributed to regionalization. The most dynamic DCs are not those with the closest links to formal regional integration schemes such as NAFTA or EU. Rather, Asian DCs did prosper most rapidly without enjoying preferential treatment in, and locational proximity to, the large European and American markets.

In essence, the main culprit for lacking integration into the world economy is a misguided domestic economic policy. Yet inappropriate economic policies can be changed. This implies that the trend towards globalization is highly unlikely to establish a two-camp world, where many DCs are caught in a poverty trap. To the contrary, globalization can be expected to further increase the long-run tendency towards factor price equalization. This does not only apply for the mobile factors of production, but increasingly also for the less mobile factors of production, such as labor. The implication for industrialized countries is that especially wages of low-skilled workers will have to decline — not necessarily in absolute amounts, but in re-

lation to wages of high-skilled workers and in relation to the rate of return on capital. Conversely, the implication for DCs is that average wages will rise as the supply of capital increases. This reasoning is supported by the Stolper–Samuelson Theorem of international trade theory. In practice, it may be difficult to quantify the resulting effects exactly, but it is hard to maintain that globalization has nothing to do with labor market problems of rich countries. Once this impact is acknowledged, there must be an impact on DCs, too.

One piece of evidence supporting the presumed labor market impact of globalization comes from economic history. Over the past century and a half, real wages converged between Europe and the developing economies of the day, i.e., Canada, the US, Argentina, and Australia, and also within Europe (Williamson 1995). Rather strong convergence of real wages for unskilled workers can be observed for 1870–1913, which was a period of comparatively high macroeconomic stability under the gold standard, and of exceptionally high international mobility of labor, capital and goods. The present situation is almost the same, except that labor mobility is restricted. For a tendency towards factor price equalization to prevail, it is sufficient that capital and goods are mobile internationally. In the era of globalization, this is exactly what happens as a result of new technologies and declining transaction costs. The historical record thus suggests that globalization provides excellent opportunities for DCs.

Another piece of evidence comes from observed changes in relative prices. The globalization hypothesis implies that the relative price of goods produced with a relatively large amount of low-skilled labor should decline on world markets, while the relative price of human-capital-intensive goods should rise. The prediction of trade theory is confirmed at least for the US, which constitute a relatively large and open market (Leamer 1993; Nunnenkamp et al. 1994): The relative price of labor-intensive goods like clothing has fallen compared with the prices of human-capital-intensive goods like automobiles and machinery.

IV. Protectionism in Industrialized Countries

The evidence in favor of the predicted link between globalization and factor price equalization implies favorable opportunities for catching-up of DCs. Nevertheless, globalization also bears a threat for DCs, at least in the short run. The reason is protectionism of industrialized countries. Protection aims at increasing the income of the relatively scarce factor of production, i.e., the factor that is most used in imports. Industrialized countries have erected trade barriers to preserve jobs in their low-skill industries. Likewise, many DCs have applied all sorts of regulations and capital controls in the past, to preserve rents for owners of domestic human and physical capital. Yet in both cases, the net result is a loss of welfare, because resources have not been allocated efficiently.

Apparently for fear of giving support to protectionist arguments, some economists have tried to downplay the link between globalization and labor markets (Krugman and Lawrence 1994; Lawrence and Slaughter 1993). This is a somewhat dangerous misconception, however. Instead it should be emphasized that economic analysis confirms first, that there are losers as well as gainers from globalization, and second, that protection is inferior to other ways of supporting the losers (Wood 1995). This applies to both industrialized countries and DCs. Capital poor DCs should encourage, rather than restrict the inflow of capital; capital rich industrialized countries have to change their production structure away from low-skill intensive manufacturing industries towards sophisticated lines of production in which there is less competition from fast-growing DCs.

True, the necessary structural change will not come for free. It may create higher unemployment as long as low-skilled workers do not find new jobs, or turn themselves into more skilled workers. But it is unlikely that structural change can be halted for long by protection, since capital and technology have become more mobile. Nor does structural change imply that today's rich countries will completely lose their industrial base to newly industrializing DCs. Despite

much talk about a general trend towards a service economy, the value added share of manufacturing in GDP (measured at constant prices) is remarkably constant over time for OECD countries (Gundlach 1993). The same result was found by Kuznets (1966) in his seminal analysis of long-run structural change 30 years ago.⁷³ Yet what has changed are the employment shares of manufacturing, which steadily decline

as a result of stronger productivity growth in this sector than in other sectors such as services. Hence, structural change induced by globalization implies an employment shift towards the service sector in industrialized countries. A similar development will occur in relatively advanced DCs, since they have to cope with the same kind of competition from below as present-day industrialized countries.

F. Summary and Conclusions

The current debate on globalization focuses on implications for labor markets in industrialized countries. Concerns are widespread that earnings and employment prospects especially of low-skilled workers in these countries are threatened by intensified worldwide competition on the markets for goods, services, technology and capital. If globalization significantly affects today's leading economies, it follows logically that its impact on the economic prospects of DCs must be far-reaching as well. The DC perspective has been largely ignored in academic and public debate so far.

For DCs, the relevant questions are: Does globalization foster or retard their industrialization? Will fiercer competition and greater mobility of production factors end up in a deepening divide between rich and poor countries? Or is the era of globalization a time of unprecedented opportunity for DCs? Overall, the findings of this study suggest an affirmative answer to the last question. The successful industrialization of many DCs indeed appears to be one of the major *reasons* for globalization. Yet globalization involves risks not only for industrialized countries, but also for DCs. Some DCs do face the threat of being delinked from the worldwide division of labor. As a result, their attractiveness for internationally mobile factors of production may further decline, unless domestic policy reforms will turn the tide.

Any evaluation of the chances of DCs to benefit from worldwide trends has to consider that globalization proceeds in various ways. Globalization implies first of all that trade ex-

pands relative to production, and that FDI grows even faster than trade. However, non-equity forms of international investment cooperation (NEC) — including licensing, joint ventures with foreign minority participation, offshore processing and strategic alliances — must not be ignored. The specific modes applied by enterprises going global mainly depend on industry- and product-specific characteristics, as well as on policy interventions. FDI tends to be preferred as a means to retain full ownership control in industries producing differentiated goods and applying sophisticated technologies. Certain types of NEC may be favored when human skills are embodied in capital goods and production processes are standardized. Government interference may limit the choices open to enterprises and, thereby, cause substitution effects between different modes of globalization. Basically, however, the evidence suggests that FDI and NEC complement each other.

The chances of DCs to become involved in the international division of labor differ between the various modes of globalization. For obvious reasons, their participation in interfirm agreements on *technology* cooperation is weak at best. This type of NEC is essentially restricted to fairly advanced partners with a similar level of technological capability. Notably joint R&D activities are unlikely to involve DC firms, as a relatively low innovative capacity is just one of the constituent properties of DCs. DC firms play a larger role when it comes to NEC agreements in more mature industries, in which market-related motives are underlying most cooperative

ventures. This does not imply that DCs are de-linked from technology transfers. Rather, inter-firm *cooperation* is not the optimal means for integrating DCs into globalization strategies with regard to R&D. Technology transfers between rich and poor countries mainly occur through FDI, which allows the investing firm to maintain control over firm-specific assets.

Recent trends in FDI indeed strongly support the proposition that DCs have become closely integrated into globalization strategies. In the early 1990s, DCs attracted about one third of worldwide FDI flows. Booming FDI resulted in a tenfold rise in their FDI-to-export ratio since 1980. Various DC groups benefited from this favorable development to a significantly different degree, however. Globalization through FDI proceeded mainly in East and Southeast Asia. At the same time, Latin American locations such as Mexico resumed their role in global sourcing and marketing strategies of TNCs, and Central Europe emerged as a new competitor for foreign risk capital. By contrast, the risk of being de-linked from globalization trends appears to be particularly high for Sub-Saharan Africa.

The contention that the integration into the world economy progressed most rapidly in Asian DCs is underscored by case studies of selected manufacturing industries. At the same time, globalization was not restricted to a narrowly defined group of DCs in the sectors considered:

– Least surprisingly, DCs are hosting a particularly large share of world production in the relatively labor-intensive textiles and clothing industries. More importantly, though, many DCs succeeded to increase their production share over time, and to achieve international competitiveness in both textiles and clothing. The example of clothing strongly supports the view that even lower-income DCs may join the globalization club. More advanced DCs are increasingly losing their comparative advantage in this particularly labor-intensive segment. These DCs have relocated production to lower-income countries, which then emerged as most competitive suppliers of clothing on OECD markets. Likewise, newcomers in Asia, Latin America and Central Europe have benefited

from non-equity forms of production sharing with Japanese, US and EU companies. Their integration into the worldwide division of labor will be further enhanced with MFA trade being reintegrated into the GATT/WTO framework.

– While some huge OECD-based TNCs continue to dominate globalization in chemicals, DCs got increasingly involved in this physical-capital-intensive industry. This refers to relatively advanced Asian NIEs in the first place. Different factor intensities explain why the number of DCs which successfully penetrated OECD markets is smaller in chemicals than in textiles and clothing. FDI has greatly supported the integration of emerging chemical producers into world markets. In major Asian and Latin American host countries, the chemical industry attracted a significant proportion of overall FDI inflows, ranking first or second among manufacturing industries. High growth projections for Asian chemical markets are likely to further enhance the attractiveness of this region for both FDI and NEC.

– Relatively sophisticated technologies and human skill requirements render it more difficult for DCs to participate in globalized production of motor vehicles. Nevertheless, some advanced DCs have emerged as new competitors in this industry, and their share in world production of both finished cars and autoparts has increased significantly. Especially in Latin America, this is mainly due to globalization through FDI by TNCs based in Triad economies. FDI was less important in Asia, but the development of local automobile production has been supported by establishing international links in this region as well. Licensing and similar interfirm arrangements were most important in this respect. Whatever the future shape of the world's motor vehicle industry will be, some non-traditional locations in the Far East, Latin America and Central Europe appear to be well prepared to meet the competitive challenges.

All in all, the findings of this study contrast with the widespread belief that only few DCs may benefit from globalization. Rather, the chances of newcomers have been further improved since recently, with advanced DCs in-

creasingly becoming *source* countries of FDI. With rising per capita income and wages, these countries are shifting towards more sophisticated lines of production and relocating labor-intensive activities to lower-income DCs. This provides the latter with new opportunities for catching-up.

Yet it mainly depends on the domestic economic policy framework whether newcomers will succeed in joining the globalization club. From the experience of the frontrunners among DCs, some basic policy conclusions emerge. *First*, and most obviously, openness towards world markets is a precondition for becoming involved in the globalization strategies of TNCs. Openness has several dimensions:

- Latecomers should join the current trend of liberalizing FDI regulations, in order to make use of foreign capital as an engine of economic growth.
- Policy disincentives which discourage foreign companies to transfer technology through licensing and similar arrangements should be removed. Thereby, the so far limited inflow of technology by means of NEC may be enlarged.
- Import liberalization is becoming more important for preventing a policy induced anti-export bias, as outright export subsidies have to be phased out under the new WTO rules. The removal of trade barriers encourages an efficient allocation of resources and, hence, improves the locational attractiveness for globalized production.

Second, under conditions of globalized production, national governments are increasingly constrained in pursuing economic policies of their own liking. Experience strongly suggests that DCs characterized by pronounced macro-economic instability are relatively unattractive locations for international investors. It follows that inflation, which is the most obvious sign of unstable economic conditions, has to be kept at bay. Fiscal consolidation is most important in this respect, because high government budget deficits are typically a major reason for high inflation. Likewise, tax rates, especially business taxes, must be moderate and levied on a broad

tax base in order not to impair the incentive to invest.

Third, investment in physical and human capital plays a crucial role in enabling DCs to participate in globalization. Enlarging the physical capital stock per worker increases labor productivity, which renders it easier to become internationally competitive and to attract foreign capital. Capital inflows, in turn, may supplement domestic investment funds. In order to benefit from this process of mutually reinforcing factors, economic policies that discourage domestic saving and investment must be avoided. In addition to fiscal and monetary discipline, financial market reforms are highly relevant in this respect, notably in DCs which are still characterized by financial repression and inefficient intermediation between savers and investors. Otherwise, such DCs may end up in a vicious circle of low and unproductive domestic investment and declining attractiveness for foreign capital.

Human capital formation is at least as important as physical capital accumulation. This is all the more so under conditions of globalization, which enhances technological diffusion because of declining transaction and information costs. Governments have an important role to play in attracting new technologies and adjusting to technological change. While the import of technology requires appropriate trade and exchange rate policies, its successful application basically depends on available human skills and, thus, on government efforts towards better education of the workforce.

Finally, globalization has proceeded along with renewed interest in regional integration schemes in both developing and industrialized countries. Obviously, institutionalized links of newcomers in globalization with major economies such as the EU and the US may help the former to become integrated into the international division of labor. Central Europe is a case in point: Economic transformation was rendered easier by preferential trade arrangements and access to foreign capital offered under the association agreements with the EU. This does not imply, however, that DCs deprived of such fortunate external conditions are going to be ex-

cluded from the growth dynamics of globalization. The experiences of Asian DCs on the one hand, and the ACP group on the other hand suggest that institutionalized links to major integration schemes are neither necessary nor sufficient for economic progress. The involvement of Asian DCs in globalization is most advanced, although they remained outside integration

schemes. By contrast, ACP countries did not make much progress, notwithstanding preferential access to EU markets. Regional integration is no substitute for reforming domestic policies where these are still inappropriate to reap benefits from globalization. Openness and a sufficient provision of public goods must figure high on the policy agenda.

Endnotes

- 1 Based on purchasing power parity estimates of GNP (World Bank 1994c).
- 2 For reasons of convenience, the term DCs as used in the following includes countries that recently have achieved or are approaching the status of an industrialized country. Mexico is considered to be part of the non-OECD area. This is because the period under consideration in this study covers the 1980s and early 1990s, while Mexico became an OECD member only in 1994.
- 3 Measured at purchasing power parity estimates (World Bank 1994c), the P.R. of China and India, for example, displayed about 20 and 15 percent of the South Korean GNP per capita. This difference is much larger than the largest difference within the group of OECD countries including Mexico, which is poorer than South Korea.
- 4 This chapter draws on Nunnenkamp et al. (1994: Chapter III).
- 5 For an overview on the types and coverage of regulations in selected DCs, see Agarwal et al. (1991) and the literature given there.
- 6 For empirical evidence on FDI liberalization, see ERT (1993) and UNCTC (various years).
- 7 See also Contractor and Lorange (1988: 14–15). Oman (1989: 15) argues that newcomer TNCs based in Japan, Europe and DCs tended to favor NEC.
- 8 See, for example, Business International Corp. (1987), Hergert and Morris (1988), Oman (1989), Dicken (1992), and *The Economist* (1993).
- 9 If not mentioned otherwise, in the following DCs comprise reporting countries of the Debtor Reporting System (World Bank 1994b). This includes transition economies in Central and Eastern Europe.
- 10 See Chapter A. Similarly, Bhagwati (1995) characterizes the greater internationalization of markets by rising trade-to-GNP ratios, a greater role of TNCs, and increased integration of world capital markets.
- 11 The temporary decline of the export-to-GNP ratio in the early 1980s is due to the drastic fall of oil prices after the peak in 1980. Consequently, nominal exports of oil exporting countries in 1987 were less than half the value for 1980.
- 12 The comparison of the export-to-GNP ratio across country groups is not meaningful because it tends to be systematically lower for large economies. Hence, the interpretation of this ratio is restricted to its development over time.
- 13 For example, sectors previously considered “sensitive” were opened to FDI and restrictions on profit remittances were removed. As a result, FDI policies of East Asian economies converged at a lower regulatory level.
- 14 The role of import liberalization for preventing a policy-induced anti-export bias became more important recently (Agarwal et al. 1995). It was increasingly difficult to compensate implicit export taxes resulting from import substitution policies by direct export promotion measures. Especially export subsidies provoked retaliation by trading partners, and are to be phased out under the new WTO rules.
- 15 According to World Bank definitions, net resource flows comprise net flows of long-term debt, net FDI, portfolio equity flows and grants (excluding technical cooperation grants).
- 16 The regulatory framework for FDI has been liberalized in various African countries, for example, by simplifying administrative procedures, concluding bilateral investment protection and promotion treaties, and acceding to multilateral treaties (UNCTAD 1995a: 24–27).
- 17 For a recent analysis of the reform process in this region, see World Bank (1994a).
- 18 Two factors must be considered in interpreting the extremely high share of portfolio investment in South Asia’s net resource inflows in 1994 (Figure 2). First, the increase of portfolio equity flows is of a very recent nature. The share in 1992 was still below 5 percent. Second, India received more than 90 percent of portfolio equity flows to the whole region in 1993 (country-specific data are not available for 1994) (World Bank 1994b).
- 19 Access barriers were substantially lowered in East Asian countries, for example (for details, see Greenwood 1993). Cases in point are South Korea and Taiwan, which had applied a fairly restrictive policy stance until the 1980s.
- 20 The growth rate of 17 percent was about the same as in the two previous years (World Bank 1994b).
- 21 The ratio for 1992 was 1.2 percentage points higher than the average ratio for developed countries during 1985–1992.
- 22 The high ratio for this group is the more remarkable as huge countries such as India are included. Similar to the export-to-GNP ratio, the share of FDI in gross capital formation tends to be lower in large countries.
- 23 Since recently, this applies to transition economies in Central and Eastern Europe as well. After the previous isolation from Western markets had been overcome, the ratio of FDI inflows to gross domestic capital formation reached 8.5 percent in 1992 (UNCTAD 1995b: Table 2).
- 24 FDI in the P.R. of China soared from virtually zero in 1980 to US\$25.8 billion in 1993, i.e., about 39 percent of total FDI flows to DCs (it should be noted, however, that important host countries such as Hong Kong, Singapore and Taiwan are not included in the Debtor Reporting System).
- 25 The subsequent assessment is restricted to 25 DCs which received FDI inflows of at least US\$40 million in 1984, in order to exclude unreasonably high 1993/1984 ratios due to extremely low base levels. This explains why transition economies, which opened up towards FDI only recently, are not included among the top performers.

- 26 FDI flows to Brazil in 1993 were only half the figure for 1984.
- 27 This development is the more remarkable as the P.R. of China more than doubled its share during this period. The decline is even larger for the 25 best performers in 1984. At that time, this group attracted 94 percent of total FDI flows to DCs. The share was down to 70 percent in 1993.
- 28 The data base on outward FDI by DCs is still deficient (see also the note in Table 4). Yet, relevant information may be drawn from various sources. In addition to the IMF's *Balance of Payments Statistics*, the OECD (1994c) has presented statistics on outward FDI by nine Asian and Latin American DCs. A recent account of intraregional FDI stocks among Asian DCs is provided by UNCTAD (1995a: Table 4); on intra-Asian investment relations, see also Agarwal et al. (1995: 24f.) and the literature given there. Finally, Page (1995) presents the evidence available for 1992 in a most informative synoptical table.
- 29 Furthermore, FDI outflows from the four Asian NIEs (especially Hong Kong and South Korea) to developed countries such as the US, the UK and Australia gathered momentum in the early 1990s. According to the evidence presented by Page (1995), these investments amounted to US\$1.9 billion in 1992, i.e., 14 percent of total FDI outflows from Asian NIEs.
- 30 For an earlier account of major determinants of intra-Asian networking, see ADB (1990) and Riedel (1991).
- 31 This may be partly due to less pronounced differences in per capita income between Latin American economies. Consequently, complementarities in production structures may be rather weak by Asian standards.
- 32 All this applies to clothing in the first place. Activities such as sewing and garment assembly are "footloose" in the sense that they may be separated from design and cutting, and located where low-skilled labor is cheap. Textile production is more capital-intensive, than clothing, and does not fit as easily into an international fragmentation of production processes (Dicken 1992: 233ff.; Oman 1989: 207ff.).
- 33 As a result, the share of textiles and clothing in overall world exports increased from 4.8 in 1980 to 7.1 percent in 1992 (UN 1994b).
- 34 Comparable data for other major source countries, notably the UK and Germany, are not available. Leather is included in the case of France and Japan.
- 35 Exports by France, Japan and the US are calculated as the sum of SITC categories 26, 61, 65 and 84 (OECD various issues). Note that the sector classification between FDI and export statistics is slightly different, especially in the case of the US.
- 36 Production data are from UNIDO's data base. They represent deflated value added in manufacturing industries, converted to 1990 US dollars.
- 37 Data are from UN (1994b).
- 38 Again, distortions may arise from MFA restrictions. This is because MFA regulations have tended to be most damaging for the most competitive DC exporters (see, e.g., Spinanger 1993).
- 39 In the OECD statistics used for the calculations in Table 5, the larger part of the increase of Latin America's market share is not allocated to specific countries in this region.
- 40 For more detailed accounts along similar lines, see OECD (1994a) and EIU (various issues).
- 41 The following observations are drawn from various contributions in ADB (1993) and from OECD (1994c).
- 42 One underlying motive was to circumvent quota restrictions. Hence, it may be argued that the MFA has in fact enhanced the globalization of textile and clothing production, notably in Asia (Oman 1989: 237; Nunnenkamp et al. 1994: 74).
- 43 Note, however, that the extent to which privileged partner countries succeeded in this respect depended critically on domestic investment conditions. Free access to EU manufacturing markets did not prevent the continuous decline of the ACP share in EU imports (Hiemenz et al. 1994: Table 2).
- 44 Processed clothing exports to the EU doubled within three years to ECU 1.3 billion in 1992, 80 percent of which were from Poland, Hungary and Romania (Nunnenkamp et al. 1994: 76).
- 45 Its share was particularly high in German FDI stocks (37 percent of all manufacturing industries in 1992) (Deutsche Bundesbank 1994). The corresponding shares amounted to 23 percent for the US by the end of 1993 and 14 percent for Japan by March 1993 (US Department of Commerce 1994; Ministry of Finance 1993).
- 46 As in the case of textiles and clothing, Eastern Europe suffered from declining production shares in the early 1990s, i.e., during transition to a market economy.
- 47 The contribution of SITC 5 to total DC exports nearly tripled from 1.8 to 4.8 percent, while its share in world exports increased only modestly from 7 to 9.1 percent (UN 1994b).
- 48 The Republic of South Africa is included under non-OECD sources in the trade statistics on which Table 7 is based, whereas this country was not considered in Table 6.
- 49 The weak representation of German investors in Asian DCs is not restricted to chemicals, but rather a general feature of past FDI patterns (Agarwal et al. 1991).
- 50 It is noteworthy that the P.R. of China's share in Japanese FDI in chemicals was still relatively low by the end of 1992.

- 51 The relevant information is available for five host countries in Asia and two host countries in Latin America (OECD 1994b; OECD 1994c). Figures in the text refer to the 1988–1992 period, except for Argentina (1990–1992), Singapore and South Korea (1988–1991).
- 52 For details, see Nunnenkamp et al. (1994: 67f., Table A6) and the literature given there.
- 53 Infringements of property rights by DCs have been widespread especially with regard to pharmaceuticals. For a detailed discussion of this issue, which is beyond the scope of this study, see OECD (1992: 77ff.).
- 54 The sector's contribution to overseas FDI stocks in manufacturing amounted to 13.1 and 17.6 percent for the US and Germany, respectively. Comparable data for other major automobile producing countries are not available.
- 55 The FDI-to-export ratio was lower in Germany (2.7 percent) than in the US (5.2 percent). Exports relate to SITC 78 and are from OECD (various issues).
- 56 Note that data on Taiwanese production are missing. Smaller assembly operations in DCs are ignored in the following. Frequently, they are due to restrictions imposed on imports of finished cars. They are, thus, hardly relevant in the context of globalization.
- 57 For example, projections are reported in OECD (1992: 41f.), according to which non-OECD countries were expected to account for about 16 percent of worldwide production of motor vehicles by 2000.
- 58 In addition to the Malaysian car Proton Saga, ASEAN countries have recurrently attempted to push the "ASEAN car" project.
- 59 However, the increase of production shares of Mexico and South Korea is somewhat overstated because of missing entries for some producers (notably Germany) in 1992.
- 60 This share was higher than in Germany (24 percent) and Japan (18 percent), whereas components and parts accounted for nearly half of automotive exports by the US.
- 61 In 1990, about 13 percent of Korea's total automotive exports consisted of parts and accessories (VDA 1994: 335).
- 62 Note that SITC 78 includes autoparts.
- 63 Brazil's motor vehicle industry has suffered from FDI outflows since 1988, which has probably been due to deteriorating investment conditions (notably as compared with Mexico).
- 64 All DCs hosted 27 percent of total German FDI stocks in the motor vehicle industry.
- 65 However, Japanese equity participation in joint ventures with Indian manufacturers has introduced modern technology into India's motor vehicle industry. As a result, this rather "moribund ... industry has been reinvigorated" (D'Costa 1995: 486).
- 66 In 1980–1986, Korean parts producers formed 21 joint ventures and concluded 160 technology licensing agreements with OECD companies (OECD 1992: 53).
- 67 For details, see Nunnenkamp et al. (1994) and the literature given there.
- 68 For each region, the five economies with the largest populations are considered, except for Sub-Saharan Africa, where Mozambique, Ethiopia and Uganda have been excluded because of data limitations.
- 69 It should be noted that high investment rates usually reflect high domestic savings. This is so because the difference between investment and domestic savings equals the current account deficit, which rarely exceeds 5 percent of GDP over longer time periods.
- 70 As a general pattern, licensing was found to be concentrated on industrialized countries and Asian DCs.
- 71 By contrast, only one quarter of respondents experienced problems in licensing out their technology within their home countries.
- 72 For Greece, it was found that licensing was complementary to other forms of technology transfer, mainly through FDI (Giannitsis 1991). In many cases, licensing was the preferred instrument for entering the Greek market before deciding on other engagements such as subsidiaries, share participation, or acquisition of licensee firms.
- 73 For example, the value added share of manufacturing has remained fairly constant at about 20 percent in the US during 1970–1992, in Germany it declined from 40 to 35 percent, and in Japan it increased from 26 to 34 percent. For fast growing DCs, such as South Korea and Malaysia, this share has strongly increased, thereby largely offsetting the decline in the share of agriculture, whereas no significant changes can be observed for services (World Bank 1994d).

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