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Winners and losers in the global economy: Recent trends in the international division of labour and policy challenges

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Winners and Losers in the Global Economy

Recent Trends in the International Division of Labour and Policy Challenges

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by Peter Nunnenkamp

CONTENTS

- Globalised markets and production patterns offer favourable opportunities to raise world income. Yet globalisation also fuels conflicts about the distribution of welfare gains within and across countries. Various developing economies are poorly prepared to meet the challenge of fiercer competition on world goods and factor markets. In industrialised countries, low-skilled workers face mounting adjustment pressures.

- Multilateral trade liberalisation represents a "win-win strategy", with only a few possible exceptions in the short run. The neomercantilist notion that the removal of trade barriers is a concession to foreign trading partners is grossly fallacious. Income gains are mainly due to the countries' own liberalisation measures. Developing countries could have raised their share in world welfare gains if they had committed themselves more strongly to binding trade liberalisation during the Uruguay Round negotiations.

- Foreign trade and direct investment patterns reveal that the international division of labour is progressing not only in a regional context but also on a truly global scale. The opportunities for new competitors for foreign capital and technology transfers depend on domestic economic policies in the first place. Exogenous factors such as the recent revival of regional integration, autonomous locational decisions taken by multilateral corporations, and technological developments cannot be blamed for failures in benefiting from globalisation.

- The strikingly different economic performance of developing countries in globalised markets and production is clearly related to the progress made with respect to macroeconomic stabilisation, physical and human capital formation, and openness towards world goods and capital markets. Asian-type success stories could be repeated elsewhere, once governments have become aware that they can no longer pursue economic policies of their own liking.

- The Triad of the EU, Japan and the United States will come under fiercer adjustment pressure if more developing countries become involved in globalisation. Industrialised countries have little choice but to promote human capital formation in order to strengthen their comparative advantages in skill-intensive lines of production. Adjustment needs have been handled most effectively in Japan so far. By contrast, high unemployment in the EU, especially of low-skilled workers, appears to be the price that has to be paid for insufficient wage flexibility and structural change.

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I. Welfare Generation and Distributional Conflicts in the World Economy

A new catchword has been born recently: globalisation. Economically speaking, globalisation means the increasing interdependence of markets and production in different countries through trade in goods and services, cross-border flows of capital, and technology transfers. Accordingly, a more sophisticated division of labour may be achieved by fragmentation of production processes on a worldwide scale. Firms may source this component from one country and that component from another country. It would then be increasingly difficult to determine where certain products that are assembled in one particular country have actually been made.

1. Specialisation through Foreign Trade

An increase in the international division of labour is by no means a completely new phenomenon. Foreign trade has grown faster than worldwide production over the last three decades or so (GATT various issues). The world economy had become more integrated long before globalisation emerged as a major issue of political and academic debate. Foreign trade is well known for providing opportunities for specialisation according to the trading partners' comparative cost advantages. It represents a powerful mechanism to raise economic welfare on a worldwide scale. Consumers and producers obtain access to final and intermediate goods and services at cheaper prices or better quality. Trade enlarges the relevant market and, thereby, offers opportunities to exploit economies of scale and reduce per-unit costs of production. Additional welfare gains may be achieved in a dynamic perspective. Foreign trade adds to competitive pressure on domestic producers. This provides stronger incentives to reduce managerial slack (i.e., the so-called X-inefficiency) and induces a permanent search for process and product innovations.

It is equally well known that the welfare-increasing properties of free trade have not prevented the persistence of restrictive trade policies. Free trade is not in everybody's interest, but involves distributional conflicts. Economic theory has shown that that production factor which is relatively scarce in a given economy may be worse off under free trade conditions than under conditions of nationally segmented production and markets. This is the basic message of the famous Stolper-Samuelson theorem (Stolper and Samuelson 1941). For industrialised countries, this theorem implies that the income position of low-skilled workers is negatively affected once trade with countries whose comparative cost advantages are shaped by a relatively rich endowment with low-skilled labour is allowed for. Hence, it is not surprising that the removal of trade restrictions is resisted by national interest groups in economic sectors for which a progressing international division of labour would result in fiercer competitive pressure in economic sectors from abroad.

A free trading environment may give rise to distributional conflicts in an international perspective as well. Welfare gains tend to be unevenly distributed across countries, and it is still heavily debated whether free trade would help convergence in per capita income between today's rich and poor countries, or would result in growing asymmetries in the world economy. An extreme view is taken by the so-called dependency school of Third World development, which still claims that industrialised "core" countries grow at the expense of developing countries at the periphery, and that international trade is used by the former to exploit the latter (Tetreault and Abel 1986; Hout 1993). According to this reasoning, poor countries could develop economically only if they remained outside the international division of labour as designed by the capitalist "core" of the world economy. In sharp contrast, mainstream economists maintain that

Acknowledgement: I highly appreciate the most productive and stimulating collaboration with my colleague Erich Gundlach. This article draws substantially on various earlier papers co-authored by him.

openness towards world goods and capital markets has a strong positive impact on economic growth, especially in developing countries (e.g., Gundlach 1996; Sachs and Warner 1995).

Trade restrictions have traditionally been used to contain distributional conflicts in the national and international arena. Low-skilled workers in industrialised countries have been protected by erecting particularly high barriers against imports of labour-intensive goods such as clothing and textiles. Many developing countries have pursued import substitution policies, i.e., they have discouraged imports in so-called infant industries in order to induce self-reliant industrialisation. Trade restrictions have retarded but not stopped the development towards a more sophisticated international division of labour. More surprisingly perhaps, more and more developing countries have liberalised their import regime unilaterally during the last round of multilateral trade negotiations in the GATT framework (Uruguay Round). Obviously, it has become more widely accepted that the protection of non-competitive factors of production involves significant costs in terms of macroeconomic welfare losses. Persistent import substitution policies have resulted in misallocation of resources, prevented the exploitation of economies of scale in narrow domestic markets, and impaired the welfare-increasing role of a competitive business environment. In other words, restrictive trade policies have turned out to be less effective in containing distributional conflicts than had been expected by many decision-makers, while welfare losses have imposed a high burden on the economies as a whole.

2. The Impact of Globalisation

All this had become rather obvious well before the term globalisation became widely used when discussing recent trends in the international division of labour and the implications these trends might have for the world market position of different countries or country groups and the income position of certain factors of production within particular countries. What has been identified by various economists as a relatively new phenomenon in the world economy is the dramatic increase in the international redistribution of ownership through cross-border capital flows since the early 1980s. Flows of foreign direct investment (FDI), for instance, have grown even much faster than international trade (IMF various issues). In addition, other forms of international investment cooperation such as licensing, offshore processing, and so-called strategic alliances between companies of different jurisdictions issues gained prominence (Nunnenkamp et al. 1994: 27–43).

What are the implications of higher capital mobility and closer interfirm cooperation across borders for welfare generation and distributional conflicts in the world economy? The consequence of recent development is that the international division of labour is pushed forward by various mechanisms at the same time. Further opportunities for specialisation emerge if trade flows are supplemented by capital flows and interfirm agreements on technology transfers. Developing countries may gain better access to internationally mobile factors of production with which they are relatively poorly endowed. In the case of capital inflows, for instance, global welfare would increase to the extent that the marginal productivity of capital in capital-poor countries exceeds productivity in capital-rich countries. Interfirm technology cooperation may enhance product and process innovations, as joint research and development (R&D) activities render it possible to share high R&D expenses and to spread fixed costs over a larger volume of production.

However, the international mobility of factors of production does not only offer additional welfare gains for the world as a whole. Globalisation also adds to distributional conflicts, both nationally and internationally, as compared to a situation with segmented factor markets. In effect, globalisation results in a closer integration of labour markets at a worldwide scale.[1] This favours high-skilled workers in industrialised countries, who have relatively few foreign competitors. By contrast, for low-skilled workers in these countries, globalisation amplifies the adjustment burden that would have resulted from international trade alone.

Low-skilled labour in industrialised countries faces an almost perfectly elastic supply of low-paid competitors around the world. Furthermore, globalisation promotes the general availability of standardised technologies. According to the Rybczynski theorem (Rybczynski 1955), this should lead to an increase in the world market supply of goods the production of which uses low-skilled labour relatively intensively, and of goods that can be produced with ubiquitous technologies. The increase in world market supply should reduce the prices of such goods, relative to the prices of human-capital-intensive and technologically advanced goods. Industrialised countries have little choice under such conditions but to foster industrial restructuring and specialise in the production of human-capital-intensive and high-tech goods. Low-skilled labour in industrialised countries is confronted with an uncomfortable trade-off: it is threatened by rising unemployment unless wage reductions, relative to the factor reward for human and physical capital, are accepted.

3. Theory and Reality: Conflicting Propositions

According to theoretical reasoning, there would be no production of low-skilled labour-intensive goods in industrialised countries (and, correspondingly, no production of human-capital-intensive goods in developing countries). Of course, reality is somewhat different. Transport costs, policy-induced deterrents to international transactions, and the immobility of some factors of production contribute to maintaining an industry structure that would be totally obsolete otherwise. The gap between theory and reality depends on the significance of transaction costs. Declining transaction costs suggest that the gap has (and will continue to) become less and less pronounced. Various constraints that have prevented firms from implementing globalisation strategies have disappeared. Thanks to the micro-electronics revolution, communication technologies have undergone a dramatic change. New production and organisation technologies such as CAD (computer-aided design) and CIM (computer-integrated manufacturing) have evolved. Successive GATT rounds have reduced trade barriers. In addition, capital markets have been liberalised, especially during the last decade, and many business services have become internationally tradable. International financial centres provide for 24-hours trading in all sorts of financial assets. Business services such as banking and insurance have been deregulated so that standardised business services are available around the world. Finally, transport costs have been reduced, since new technologies allow for economies of scale in transportation and tend to reduce the volume of international transport in raw materials necessary to produce one unit of final output.

As a consequence of declining transaction costs, multinational corporations can choose among an increasing number of options in order to engage in cross-border ventures and international investment cooperation. FDI provides a means to jump over remaining protectionist fences. Likewise, restrictions imposed on foreign investors, e.g. the trade-related investment measures (TRIMs) discussed during the Uruguay Round, may be circumvented by referring to non-equity forms of international investment cooperation. In particular, declining transaction costs offer better opportunities for relocating the production of low-skilled labour-intensive goods and standardised lines of manufacturing to developing countries. It follows nearly by implication that developing countries should benefit from globalisation. If so, globalisation would improve the chances for economic catching-up with industrialised countries and support international convergence of per capita income. It seems to be premature to "forget convergence" simply because "the overwhelming feature of modern economic history is a massive divergence in per capita incomes between rich and poor countries" (Pritchett 1996: 38). Apart from the ongoing debate on a reasonable interpretation of past growth patterns, declining transaction costs suggest that the future is likely to differ in important ways from the past.

This is not to ignore that several arguments may be raised against the proposition that globalisation amplifies adjustment pressure for

industrialised countries and offers better opportunities for developing countries. First, it is open to debate whether the international division of labour is progressing really on a *global* scale, or rather within a *regional* context. There is a strong revival of regional trade arrangements, of which the deepening and widening of European integration and the formation of the North American Free Trade Association (NAFTA) are the most prominent examples. Countries remaining outside major regional integration schemes would run the risk of being delinked from the international division of labour if regionalisation, rather than true globalisation, were the dominant feature in the world economy. This argument implies that only a small group of Third World economies with strong institutionalised ties with major regional groupings in the developed world may benefit from closer trade and investment relations.

Second, related to this, some economists consider organisational innovations at the enterprise level, including lean production and just-in-time delivery, to be the driving force of interfirm networking with regard to sourcing and marketing (e.g., Oman 1994). Such a networking is expected to emerge primarily on a regional basis. According to this line of reasoning, proximity between producers and their customers is becoming more important, whereas the relevance of international differences in wage costs in shaping locational choices of producers and investors is expected to decline. If so, the chances of low-wage developing countries to induce catching-up processes would be impaired. This reasoning is in obvious conflict with the globalisation hypothesis, according to which declining transaction costs encourage the fragmentation of production processes on a global scale and render less important the proximity of producers and customers.

Third, low-wage countries are sometimes believed to end up in a poverty trap if they specialise according to their comparative cost advantages in low-skilled labour-intensive goods and highly standardised lines of production (Körner 1995). This view maintains that such a specialisation increases the risk of being left behind with regard to technological progress. At least implicitly, it follows from this argument that only few developing countries can take part in globalisation, namely those which have established a fairly sophisticated manufacturing base through government support granted to infant industries.

Fourth, the recent boom of FDI and other capital flows may provide a misleading impression on the chances of capital-poor countries to attract foreign investment funds and thereby add to their own domestic savings. Almost perfectly mobile *financial* capital flows do not necessarily imply an increase in *physical* capital mobility, which is tantamount to widening current account imbalances.[2] As a matter of fact, physical capital flows across countries were surprisingly low in the past, as is indicated by a strong positive correlation between national saving and investment rates (Feldstein 1994). This correlation should become weaker over time if production is increasingly globalised.

Finally, global savings may fall short of meeting increasing demand for foreign capital. More and more countries, including transition economies in Central and Eastern Europe as well as developing countries that have removed capital controls, are approaching world capital markets. This has fuelled fears that new competitors can only attract capital inflows, especially FDI, at the expense of traditional recipients.[3] Moreover, the frequently noted concentration of FDI in developing countries on a few major recipients seems to suggest that newcomers face bleak prospects in attracting a significant share of FDI (e.g., UNCTAD 1995a: 9). By contrast, the globalisation hypothesis does not consider international capital transfers to be a zero-sum game, but claims that there will be additional capital flows if new investment opportunities emerge (Bergsman and Lall 1995).

These conflicting propositions figure prominently in the subsequent discussion of major factors that are driving the integration of international goods and factor markets. The focus is on significant changes in the world economic environment over the last decade or so and on the possible implications of these changes on the generation and distribution of economic benefits to be reaped from the internationalisation of goods and factor markets.

II. Integration of Goods Markets: Causes and Possible Implications

Before returning to international investment relations, and in particular the competitive position of different countries with regard to capital inflows and technologically motivated cooperation, major changes in the world trading environment are assessed in the following sections. Trade policies provided a startling picture over much of the 1980s and early 1990s (Nunnenkamp 1993). Multilateral trade negotiations in the context of the Uruguay Round of the GATT were stalled for years and close to a complete breakdown. By contrast, the significance of unilateral trade policy reforms indicated that foreign trade liberalisation became more widely accepted as a means to achieve an efficient allocation of scarce resources and foster economic development. Moreover, the world economy witnessed a strong revival of regional trade arrangements. It was feared that regionalism could result in hostile trading blocs; concerns about "fortress Europe" figured prominently in this respect.

1. Multilateral Trade Liberalisation

The Uruguay Round of the GATT was finally concluded after more than seven years of negotiations in December 1993. The achievements in lowering barriers to international trade are significant, although they fall short of high expectations at the beginning of negotiations.[4] In summary, the Uruguay Round was an attempt to stop the trend towards more and more exceptions to the validity of multilateral GATT principles becoming the rule, and to extend GATT discipline to new trade issues.

a. Major Results

Market access for industrial goods was improved by further tariff reductions. However, import tariffs remain relatively high for industrial goods in the production of which many developing countries enjoy a comparative advantage (e.g., textiles, clothing, and electrical goods). Moreover, tariff escalation persists, i.e., the processing of goods by foreign trading partners is still discouraged by levying higher tariffs on processed goods than on unprocessed goods. Tariff escalation may hinder developing countries from becoming involved in globalised production. Market access was also improved in agriculture, which had been the major stumbling bloc to the conclusion of the Uruguay Round. It was agreed to replace highly distortive quantitative restrictions by import tariffs and to reduce the latter by 36 per cent, on average, within six years. In addition, the subsidisation of agricultural products and agricultural exports is to be curtailed.

Various steps were taken to achieve better adherence to GATT rules. The GATT conformity of free trade areas and customs unions shall be checked more rigorously than in the past. In the case of acute balance-of-payments crises, import restrictions should consist of price-related measures and must be removed if they are no longer justified. The conditions under which anti-dumping measures may be applied were defined more precisely. Safeguard clauses in the case of a sudden import surge shall be applied in principle on a non-discriminatory basis, rather than selectively against particular trading partners. More discipline of trading partners was also aimed at by replacing the GATT by the newly created World Trade Organization (WTO). Thereby, all previous GATT agreements, including various separate codes, were subsumed under one legal entity and member countries can no longer opt out of specific obligations ("à-la-carte approach"). The universal applicability of trading rules is expected to enhance their enforceability. It remains open to question, however, whether the revised dispute settlement mechanism will result in more effective sanctions against breaches of WTO rules. Especially the major players in the world economy may not turn to the WTO when trade disputes emerge but rather rely on their own potential for retaliation and favour dispute settlement on a bilateral basis.[5] The major partner will then

dominate the rules of the game, which may reduce the gains from international trade for weaker trading partners.

The Uruguay Round addressed various areas in which GATT rules did not exist before, or were not applied. First of all, it was agreed to phase out the Multifibre Arrangement (MFA), which had placed trade in textiles and clothing outside the multilateral framework for decades. This enables developing countries to make better use of their comparative cost advantages. However, the reintegration of MFA trade into the WTO is subject to a transition period of ten years. Second, TRIMs, such as export obligations and local-content requirements imposed on foreign investors, figured on the agenda. Cross-border investment relations could have been encouraged if it had been decided to fully apply the national treatment principle of the GATT/WTO (which means equal treatment of domestic and foreign products once border charges are paid) and to enforce the prohibition of quantitative restrictions in the context of TRIMs. However, the agreed list of measures which are considered to violate these principles remained incomplete. The third issue concerns trade-related intellectual property rights (TRIPs) such as patents, copyrights and trademarks. The reluctance of various developing countries to protect property rights and agree to internationally binding rules was finally overcome. Some protection in this area is economically justified, in order to provide innovators with sufficiently strong incentives to engage in R&D activities.

Fourth, in the Uruguay Round it was attempted to extend GATT/WTO principles to trade in services, including finance, insurance, transport and communication. Trade in services has become an important issue, as potential welfare gains should be particularly large in this area where trade barriers have typically been fairly high. The increasing tradability of business services can be regarded as a major driving force of globalisation, considering that the fragmentation of production processes depends on the availability of such services in various locations.[6] This implies that countries in which the provision of business services is seriously deficient have less favourable prospects of attracting investors in manufacturing. Yet, the Uruguay Round made only limited progress in liberalising trade in services on a multilateral scale. Negotiations resulted in the General Agreement on Trade in Services (GATS), which represents a highly complex system of country- and sector-specific concessions and exceptions. Each country had the option to name those service sectors for which most favoured nation (MFN) treatment was *not* to apply. Furthermore, conditions for market access and national treatment were not defined universally, but specified in another set of country specific annexes on trade concessions. Hence, GATS has achieved little more than obliging trading partners to make restrictions transparent and negotiable for those services for which MFN treatment was not ruled out from the very beginning.

b. Welfare Effects

Various studies have assessed the trade and welfare implications of the Uruguay Round.[7] According to a recent GATT estimate, world exports in 2005 are expected to be 9–24 per cent higher than without the Uruguay Round. The same study revealed gains in world income (as of 2005) in the order of 0.3–0.9 per cent. Welfare gains are expected to increase to 0.5–1.4 per cent of world income, if some of the dynamic effects of the Uruguay Round are taken into account. The significant margins of the estimated trade and welfare effects are due to different specifications of the applied simulation model. The Uruguay Round effects on trade and income become larger if imperfect competition and increasing returns to scale are allowed for in the simulations. Moreover, the dynamic specification of the model assumes that first-round income gains, induced by trade liberalisation, result in higher savings, which would translate into additional investment.

The margins with regard to trade and income effects of the Uruguay Round widen further, once various studies are compared. The simulation results of all relevant studies are based on computable general equilibrium models, but the specific structure of these models and the underlying assumptions vary considerably. Differ-

ences relate, inter alia, to the degree of disaggregation by countries and sectors, the liberalisation measures considered in the models, critical parameter values such as supply and demand elasticities, and the time horizon of simulations.

The different estimates of the trade and welfare effects of trade liberalisation have to be interpreted with great caution. Some Uruguay Round results are qualitative in nature and do not lend themselves easily to a quantitative assessment. Consequently, the GATT estimate reported above took no account of any implications the agreement on GATS may have on trade and welfare. Likewise, various dynamic effects of trade liberalisation are difficult, if not impossible to quantify. This refers especially to procompetitive effects which may strengthen the incentives to produce new goods and apply innovative production techniques. Furthermore, all simulations are benchmark studies; they assume that the structure of the world economy remains constant throughout the period under consideration and that the Uruguay Round does not alter net capital flows between countries. Finally, an eventual breakdown of trade negotiations could have resulted in outright "trade wars" so that the Uruguay Round may be credited with having prevented the welfare losses ensuing from such conflicts. In summary, the Uruguay Round may have far-reaching implications that simulation models cannot capture.

Conceptual limitations and ambiguities notwithstanding, the estimates on the welfare implications of the Uruguay Round offer some relevant insights. Various studies have two important findings in common. First, most countries are going to benefit from multilateral trade liberalisation, though not necessarily to the same degree. Second, welfare gains are largely due to the countries' own liberalisation measures, rather than to trade concessions by their foreign trading partners.

The first finding means that multilateral trade liberalisation represents a "win-win strategy" with few exceptions. About two thirds of worldwide welfare gains tend to be concentrated on industrialised countries. It should be noted that the EU, which was mainly responsible for various crises in concluding the Uruguay Round, belongs to the major winners after its conclusion. Taken together, developing countries are also going to benefit. However, the estimated welfare effects vary tremendously within this heterogenous group of countries. A World Bank team, for instance, found exceptionally high welfare gains (in per cent of national income) for Asian countries such as Malaysia and Thailand (Harrison et al. 1995). Relatively advanced developing countries that are net exporters of agricultural products are generally expected to benefit more than low-income countries that are net importers of agricultural products.

Some countries of the latter group may even suffer from minor income losses in the short run. This is because the outcome of the Uruguay Round tends to have an adverse effect on the terms of trade of commodity-based economies, e.g. in Sub-Saharan Africa. Commodities were not subject to significant trade restrictions even before the Uruguay Round, so that there is little to gain for commodity exporters in terms of market access in the short run. At the same time, higher import prices can be expected for countries that are largely dependent on food imports, the world market prices of which tend to rise once the subsidisation of agricultural production and exports is curtailed in major food exporting countries. In the long run, however, the outcome for low-income and (net) food importing countries may be different. In the past, depressed world market prices of food items added to the discrimination of agricultural producers and exporters in many developing countries. The Uruguay Round agreements on agriculture may induce net food importers to remove discriminatory policies and encourage economic restructuring. Welfare effects may then turn positive in the long run.

The short-term effects of the Uruguay Round seem to suggest that multilateral trade liberalisation leads to larger divergence of per capita income between relatively advanced and poor countries. The second common finding of various studies qualifies this conclusion significantly. The concentration of welfare gains on industrialised countries is mainly due to their own liberalisation measures, notably with regard to agriculture and MFA trade. Likewise, the bene-

fits of countries such as South Korea are largely attributable to own commitments made during the negotiations. The principal winners of the Uruguay Round are those countries that went furthest in terms of domestic liberalisation. Hence, low-income countries could have increased their share in worldwide welfare gains, if they had used the Uruguay Round to reduce the costs of persistent protection in the national realm.[8] This applies especially to economies in Sub-Saharan Africa which made few substantial commitments on removing national trade barriers (Sorsa 1995).

All in all, the assessment of the Uruguay Round reveals that the political set-up of multilateral trade negotiations is rather puzzling from an economic point of view. Typically, the parties involved aim at better access to foreign markets and consider domestic liberalisation only to be a concession made for the benefit of trading partners. Reciprocity is the catchword among major players, which means the balancing of mutual concessions. Many developing countries insist (and can legally do so) on preferential treatment in terms of privileged market access for their exports and less binding rules with regard to their import restrictions. Economically, multilateral trade negotiations should rather be considered a means to lock domestic liberalisation to an international anchor and, thereby, maximise welfare gains. For developing countries it follows that the special treatment they receive in the GATT/WTO framework is a mixed blessing at best, and a Pyrrhic victory at worst, especially if the incentives for structural change are weakened in this way.

2. Regional Integration

a. Possible Conflicts

As mentioned earlier, trade liberalisation during the last decade went beyond what was finally agreed upon in multilateral negotiations. Various developing countries implemented structural adjustment programmes, which typically included substantial reductions in import barriers. The consequence of the collapse of socialism and central planning in Central and Eastern Europe was that transition economies tried hard to integrate themselves into the international division of labour. This involved drastic liberalisation of foreign trade regimes.

In addition, trade liberalisation was pursued within regional integration schemes. Major aims of free trade areas and customs unions are to promote intra-regional specialisation according to the member countries' comparative advantages, and to enhance the region's attractiveness for foreign capital inflows. While integration schemes may be instrumental to overcoming the segmentation of national markets on the regional level, a potential dilemma is involved on a global scale once member countries enjoy preferential treatment vis-à-vis outsiders. In contrast to market-driven regionalisation, institutionalised regionalism conflicts by definition with the fundamental GATT/WTO principles of non-discrimination and MFN treatment.

As a matter of fact, Art. XXIV of the GATT Treaty authorises derogations from MFN treatment, if free trade areas and customs unions cover "substantially all" the trade among member countries and do not raise trade barriers against outsiders. Especially the second condition is meant to prevent negative income and employment effects of regional integration schemes on non-member countries. Such adverse effects are most likely if integration schemes divert trade and capital flows away from non-member countries to member countries, rather than creating additional trade and capital flows among member countries at no other country's expense. In practice, it is fairly difficult to disentangle trade and investment creation from trade and investment diversion. One would have to know how intra-regional and extra-regional trade and capital flows would have developed without regional integration. Unavoidable ambiguity in this respect may have added to difficulties in enforcing the GATT/WTO conformity of free trade areas and customs unions. Nonetheless, it is rather striking that none of the more than 100 preferential trade arrangements that had been notified to the GATT until 1994 was rejected as inconsistent with Art. XXIV.

The European Union has contributed a lot to the revival of regional integration in various parts of the world. Different starting conditions notwithstanding, the EU was frequently considered a model, notably by developing countries in Africa and Latin America. At the same time, the EU exemplifies the potential conflict between regionalism and multilateralism. In addition to intra-EU liberalisation, the EU maintains a multi-layer system of preferential trading arrangements with third countries on a reciprocal or unilateral basis.[9] The consequence of the EU's extremely discriminatory trade policies was that only about one quarter of total EU trade and 60 per cent of extra-EU imports were conducted under MFN conditions in the late 1980s and early 1990s, compared with almost 90 per cent of US trade (Sideri 1990; GATT 1993). Traditionally, regionalism took precedence over multilateralism. In the Community's own words, trade policies reveal the EU's "enthusiastic support for and active involvement in free trade arrangements of a regional character" (GATT 1991: 32).

Economic integration in Europe proceeded along two lines. First, the existing EU members deepened their integration by further liberalising and harmonising economic policies. The completion of the Internal Market and the planned introduction of a common currency are clear indications to this effect. Second, EU membership was enlarged, recently as a result of the accession of the EFTA countries. Integration widening will continue; although accession of European transition economies is still pending, they are benefiting from substantial trade preferences since the conclusion of the Europe Agreements, which have put transition economies well ahead of all developing countries in terms of conditions of access to EU markets.

All this had raised concerns that European integration might degenerate into a "fortress Europe". Many developing countries feared that trade and capital flows would be diverted away from them to low-wage locations at the EU periphery and associated countries in Central and Eastern Europe. Moreover, partly as a response to integration deepening and widening in Europe, the United States concluded the NAFTA agreement with Canada and Mexico, and launched the Enterprise for the Americas Initiative. The EU bears some responsibility for the recent change in US trade policies: "After having guaranteed the functioning of the multilateral system of trade negotiations ... for more than 40 years, ... the United States has lost confidence in the effectiveness of the GATT process and will likely turn towards a new trade strategy favouring the establishment of additional free trade zones under US leadership and a policy of aggressive bilateralism" (Stehn 1993: 3).

Arguably, this move renders it more difficult for developing countries, except those being part of major integration schemes (Mexico) or benefiting from close institutionalised ties with such schemes, to participate successfully in the international division of labour. This may explain why many outsiders of the EU and NAFTA would like to become insiders. However, requests for accession have met with lukewarm response by present member countries. Consequently, most developing countries may have had little choice but to take a second-best approach towards regional integration, i.e., to strengthen economic relations among themselves, either through institutionalised regionalism as in Latin America (e.g., MERCOSUR) or market driven regionalisation as in Asia.

b. Global and Regional Trade Patterns

Although conclusive evidence on the significance of trade diversion induced by regional integration schemes is almost impossible to produce, recent trends in intra-regional and extra-regional trade allow for some tentative conclusions on whether regional, rather than global networking was the dominant feature in the world economy during the 1980s and early 1990s. Table 1 offers several interesting insights in this respect. First of all, it is not surprising that intra-regional trade linkages are clearly most developed in Europe, considering the EU's long tradition and advanced stage of economic integration. More than two-thirds of total EU exports go to neighbouring countries (other EU members, EFTA countries, and Central and Eastern Europe). However, the share of extra-regional exports did

Table 1 – Intra-regional and Extra-regional Exports of Selected Countries and Regions, 1980 and 1993

	1980		1993		Ratio
	US$ billion (1)	% of total exports (2)	US$ billion (3)	% of total exports (4)	1993/1980 (3) : (1) (5)
EU exports to:					
World	689.6	100.0	1336.0	100.0	1.9
EU	384.6	55.8	761.6	57.0	2.0
EFTA	76.3	11.1	126.2	9.4	1.7
CEE[a]	13.1	1.9	30.7	2.3	2.3
Rest of world	215.6	31.3	417.5	31.3	1.9
US exports to:					
World	216.6	100.0	439.2	100.0	2.0
Canada	34.1	15.7	91.9	20.9	2.7
Latin America	38.0	17.5	75.3	17.1	2.0
Rest of world	144.5	66.7	272.0	61.9	1.9
Latin America's exports to:					
World	107.9	100.0	165.8	100.0	1.5
US	34.9	32.3	75.3	45.4	2.2
Canada	2.8	2.6	2.9	1.7	1.0
Latin America	23.0	21.3	33.9	20.4	1.5
Rest of world	47.2	43.7	53.7	32.4	1.1
Japan's exports to:					
World	129.8	100.0	360.9	100.0	2.8
Asian DCs[b]	36.5	28.1	135.3	37.5	3.7
Rest of world	93.3	71.9	225.6	62.5	2.4
Asian DCs' exports to:[b]					
World	161.9	100.0	647.3	100.0	4.0
Japan	32.6	20.1	78.4	12.1	2.4
Asian DCs[b]	38.8	24.0	241.2	37.3	6.2
Rest of world	90.5	55.9	327.7	50.6	3.6
Memorandum:					
World exports	2000.9	–	3707.6	–	1.9

[a]CEE: Central and Eastern Europe, excluding former USSR. — [b]Asian DCs: developing countries in Asia, excluding Middle East.

Source: UN (1995).

not decline further since 1980. The process of completing the Internal Market had little impact on the relative importance of intra-EU trade until 1993. EU exports to Central and Eastern Europe continued to play a minor role shortly after the collapse of central planning, when institutionalised economic cooperation between the EU and transition economies gained momentum. The growth of EU exports to both member countries and non-European countries was largely in line with the growth of world trade in 1980–1993. As far as the EU is concerned, the international division of labour has proceeded both regionally and globally.

Second, intra-regional trade has traditionally been much less significant for the United States than for Europe, even if US exports to all Latin American countries are considered to be part of regional trade relations. US exports to Canada grew overproportionally, but the United States resemble the EU in two important respects: Intra-regional and extra-regional trade increased at a similar rate in 1980–1993 and total US export growth was in line with world export growth. By contrast, the expansion of Latin America's trade relations with non-American countries remained marginal and was clearly below overall export growth. Nonetheless, the evidence for a regionalisation of Latin American trade patterns is weak. While the United States absorbed a significantly larger share of Latin American exports in 1993 than in 1980, Latin American partner countries continued to account for only one fifth of the region's overall exports. Renewed attempts at regional integration were thus not effective in raising the share of trade among Latin American economies until 1993.[10] Possible effects of the formation of NAFTA in 1992 are not yet reflected in the available data. Expectations are, however, that "NAFTA will have only a small impact upon the rest of the world" (Bouzas 1995: 15). Most strikingly perhaps,

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NAFTA has been estimated to have only marginal trade diversion effects on non-member countries in Latin America.[11]

Third, regional trade relations expanded most rapidly in Asia. Asian developing countries absorbed a rising share of Japanese exports and trade among Asian developing countries soared by a factor of 6.2 in 1980–1993. It should be noted that substantially enlarged regional networking in Asia was market-driven, in contrast to the institutionalised regionalism elsewhere. More importantly though, regional networking in Asia is highly unlikely to have retarded the globalisation of Asia's trade relations. Among the countries and regions considered in Table 1, it is only for Japan and Asian developing countries that extra-regional exports grew faster than world trade. The share of exports of Asian developing countries to non-Asian destinations in world exports doubled to nearly 9 per cent in 1993.

The regional structure of EU imports of manufactures underscores that close institutional ties with major regional integration schemes are neither necessary nor sufficient to participate successfully in the international division of labour through trade.[12] Developing countries of Africa, the Caribbean and the Pacific region (the so-called ACP group) were granted higher trade preferences by the EU than any other developing country. Nevertheless, they failed to increase their share in EU imports of manufactures. By contrast, various Asian developing countries were most successful in penetrating EU markets, despite missing trade privileges and geographical distance.

Overall, recent trade patterns contradict the notion that regionalism is the dominant factor shaping the international division of labour. Rather, closer trade linkages have emerged both regionally and globally. Membership in, and privileged market access to major integration schemes per se are unlikely to advance the international competitiveness of trading partners. Especially the Asian experience suggests that institutionalised ties with regional integration schemes matter less than domestic economic policies when it comes to explaining success and failure in reaping benefits from international trade. This is not to deny that countries without such ties could have performed even better, if regional groupings had liberalised externally, parallel to internal liberalisation, and had refrained from discrimination against non-associated countries in particular.

Regionalism inherently carries the risk of trade diversion at the expense of outsiders. Such risks could be minimised if the provisions of GATT Art. XXIV were rigorously enforced. Regional integration and multilateral trade liberalisation could indeed reinforce each other, if two requirements were met: All preferential trade arrangements should be "GATT/WTO-Plus" accords in the sense that regional liberalisation goes beyond multilateral commitments, while no further trade barriers are erected against non-members. In addition, trading partners would have to commit themselves to open regionalism by relaxing restrictive accession procedures. Potential members should be allowed to join once they are prepared to adhere to the regional liberalisation accord.

III. Capital Transfers and International Investment Cooperation

In addition to trade, international capital flows represent a powerful mechanism pushing for a more sophisticated division of labour. The effects on structural change in production patterns in general, and on relocation of labour-intensive and standardised lines of manufacturing to developing countries in particular, depend on the actual degree of capital mobility. The growth prospects of various countries may be impaired if private foreign capital owners consider just a few investment locations to be attractive. Investment in most economies would then remain constrained by relatively low domestic savings (plus foreign aid, which is not considered in the following) as well as insufficient access to technology.

1. International Mobility of Capital

Theoretical reasoning suggests that mobile capital will flow to countries which are relatively poorly equipped with this production factor. This is because the marginal productivity of capital and, hence, the return to capital should be higher there than in capital-rich economies. By attracting foreign capital inflows, capital-poor countries may add to their own domestic savings, thereby increasing investment and promoting economic growth. In other words, capital mobility across borders implies that national savings and investment rates should be uncorrelated with each other.

In reality, however, high investment rates usually went along with high domestic savings. The difference between investment and domestic savings, which equals the current account deficit, rarely exceeded 5 per cent of gross domestic product (GDP) over longer time periods. Econometric analyses pointed to a de facto segmentation of capital markets, especially in the 1960s and 1970s; the correlation between savings and investment rates in OECD countries was found to be close to one.[13]

Does this mean that, in contrast to theoretical predictions, capital is rather immobile? It is indeed hard to dispute that capital owners reveal a fairly strong home country bias: "Ignorance, risk aversion and prudence keep capital close to home" (Feldstein 1994: 10). Nevertheless, it can be maintained that international capital transfers have played an important role in the world economy, and are likely to gain prominence in the future. First of all, empirical evidence indicates that the home country bias of capital owners has become weaker in the 1980s.[14] Second, capital mobility is underestimated if, as typically done, the correlation between savings and investment rates is calculated on the basis of long-term averages of these rates; this procedure "ignores net capital flows that have occurred in reverse directions during the period over which averages are taken" (Sinn 1992: 1165). Calculations based on annual data reveal that the savings-investment link has become looser after 1973 and support the proposition of an increasing capital mobility over time. Third, currency risk appears to have been the main reason for the strong home country bias of capital owners in the past. This deterrent to greater capital mobility may become less significant in the future. As argued below, globalisation adds to the incentives of governments to strive for macroeconomic stability, which would help containing exchange rate volatility. Finally, some forms of capital seem to have become truly global already. This refers especially to FDI which "does contribute to real cross-border capital flows" (Feldstein 1994: 15).

2. The Rise and Distribution of FDI

The recent boom of FDI underscores its special role in transferring national savings across borders. Worldwide FDI flows soared from an annual average of US$92 billion in 1983–1988 to US$226 billion in 1994 (UNCTAD 1995b: Annex Table 1). The subsequent assessment of FDI does not present a complete picture on the international allocation of mobile factors of production, since other forms of capital and technology transfers are neglected. It should also be noted that the conceptual limitations to assess the degree of FDI diversion are still more serious than in the case of trade diversion. Nonetheless, recent FDI patterns offer interesting insights, notably on whether regional integration schemes have induced significant changes in the worldwide distribution of FDI flows and on the widespread belief that FDI is highly concentrated on just a few host countries. In contrast to short-term and more volatile capital flows such as portfolio investment, FDI typically represents a longer lasting commitment of foreign investors to a host country. Hence, FDI provides a better indication of the internationalisation strategies of multinational corporations, especially in manufacturing.

Industrialised countries have traditionally attracted the bulk of FDI inflows (Table 2). Recently, however, their share in total inflows has declined from about four fifths to slightly less than 60 per cent in 1994. Developing countries as well as transition economies in Central and Eastern Europe have emerged as important hosts

of FDI inflows. This indicates that an increasing number of countries has become involved in internationalisation strategies of multinational corporations.

Table 2 – Regional Distribution of World FDI Inflows, 1983–1994[a] (per cent)

	1983–88	1989–91	1992–94
Industrialised countries	78.4	81.2	62.1
EU	30.0	47.0	36.9
United States	37.6	24.1	17.9
Japan	0.4	0.7	0.6
Developing countries	21.6	18.3	35.2
Africa	2.3	1.8	1.5
Latin America	8.1	5.6	9.6
Asia	11.0	10.7	23.8
China	2.0	2.0	12.0
Asian NIEs[b]	4.5	4.1	5.3
ASEAN(4)[c]	1.9	3.4	5.1
Central and Eastern Europe	0.0	0.5	2.8
Memorandum:			
Total inflows (US$ billion)	91.6	190.2	201.5

[a]Annual average. — [b]Newly industrialising economies: Hong Kong, Singapore, South Korea and Taiwan. — [c]Indonesia, Malaysia, Philippines and Thailand.

Source: UNCTAD (1995b: Annex Table 1).

The boom of FDI may reflect a regionalisation of international investment activities rather than true globalisation. If so, the formation of regional blocs should have resulted in FDI diversion away from non-member countries. The deepening of EU integration in the aftermath of the Internal Market programme of 1985 may provide a case in point. The EU indeed attracted substantially higher FDI inflows in 1989–1991 than in 1983–1988 (US$89 billion versus US$27 billion on an annual average) (UNCTAD 1995b: Annex Table 1). As a result, the EU's share in worldwide FDI inflows increased from 30 to 47 per cent (Table 2). EU integration caused higher intra-EU FDI since European companies became more eurocentric, and it also induced higher FDI inflows from Japan and the United States.[15] The EU's attractiveness for foreign risk capital was largely because international investors anticipated the completion of the Internal Market and its extension to prospective EU member countries. Fears of restrictive EU trade policies may have induced FDI in some instances, e.g., Japanese investment in the automobile industry, as FDI offered a means to jump over protectionist fences. However, the larger part of FDI appears to have been motivated by market integration (both in manufacturing and services) and cost advantages in member countries at the EU periphery.

The rise of intra-EU FDI mainly affected EU FDI outflows to the United States, while European companies neglected developing countries only temporarily and largely because of home-made economic disturbances in Latin America. Likewise, European integration has not led US and Japanese investors to curtail their FDI in developing countries. Hence, the boom of FDI flows to the EU during the process of completing the Internal Market is rather unlikely to have resulted in significant FDI diversion at the expense of developing countries. Moreover, it was a rather short-term phenomenon. In 1992–1994, the EU's share in worldwide FDI inflows went down to 37 per cent. This supports the earlier conclusion that regional integration must not be interpreted as the dominant feature of the international division of labour.

Further evidence to this effect is provided by FDI patterns in Asia. The share of nine dynamic Asian developing countries[16] in worldwide FDI inflows rose by a factor of 2.7, when comparing 1983–1988 and 1992–1994 (Table 2). FDI relations *among* developing countries in Asia gathered considerable momentum since the early 1980s, but they can only partly explain the rising share in worldwide FDI flows.[17] It should also be recalled that Asian developing countries did not maintain close institutionalised ties with either the EU or NAFTA. Hence, the dramatic shift of FDI to this region has to be attributed to a significant extent to globalisation effects.

Another issue concerns the frequently noted concentration of FDI in developing countries on a few fairly advanced host countries. This observation seems to imply that most developing countries are severely restricted when it comes to participating in the increasing division of labour through FDI, which constitutes a major channel of international technology transfers. If, for whatever reason, foreign investors focussed persistently on the same small group of host economies, the majority of developing countries would probably receive less capital and technol-

ogy than would be necessary to derive benefits from the globalisation of production and markets. These countries could then be caught in a poverty trap: Globalisation would only support developing countries that have a command of the relevant technologies, but would not induce economic development in less advanced countries.

However, the assumption of a more or less constant pattern of FDI flows to a few selected countries is hardly compatible with recent changes in the regional distribution of FDI inflows. Besides Asia, Central and East European economies in transition increased their share in worldwide FDI flows. This development is obviously related to progress achieved in economic transformation, which encouraged the integration of transition economies into the international division of labour. By contrast, Latin America, which had been the preferred host region for FDI in the Third World until the outbreak of the foreign debt crisis, appeared to be the main loser in the 1980s. Recently, though, FDI flows to Latin America have recovered. Furthermore, the regional share in worldwide FDI flows is rather misleading when assessing the position of Latin American economies in the context of globalisation. Several countries in this region (including Argentina, Chile and Mexico) recorded tremendous FDI inflows in the early 1990s (Nunnenkamp 1996: 4–7). This indicates that attractiveness for FDI can be regained in the aftermath of major economic crises, once consistent economic policy reforms are implemented. The counterfactual is provided by Brazil, which was less reform-minded until recently and lost its previous top position among developing countries with regard to FDI inflows. Latecomers in economic policy reform such as Brazil may face an uphill struggle against competitors which are presently absorbing the bulk of FDI inflows. Yet, international competition for FDI is not a zero-sum game (Bergsman and Lall 1995). Hence, if a country such as Brazil restores its attractiveness for foreign investors, *additional* FDI may be the result, rather than Brazil having to divert FDI from other locations.

The evidence on FDI contradicts the notion that only few developing countries may benefit from globalisation. While more than two thirds of FDI flows to all developing countries have continuously been concentrated on the ten largest host economies (UNCTAD 1995a), the country composition of the group of best performers has changed over time. Even more importantly, it is *per capita* FDI inflows that matter for the chances of newcomers to enhance their locational attractiveness for foreign investors. In per capita terms, various small Latin American economies, for example, have proved more attractive than their large neighbours (Nunnenkamp 1996: 7). Finally, the chances of newcomers to participate in globalisation have further improved since some relatively advanced developing countries have emerged as foreign investor countries.[18] Notably in Asia, foreign investors based in newly industrialising countries are heavily engaged in less advanced economies in the region (especially in China).

Taken together, the empirical evidence offers two major conclusions. First, booming FDI is not just a consequence of the recent move towards regional integration, but reflects true globalisation to a significant extent. Second, the frequently noted concentration of FDI on a small group of relatively advanced host economies tends to underrate the chances of newcomers, especially of low-income developing countries, to derive economic benefits from globalisation by attracting FDI.

3. Generation and Application of Technological Innovations

The concern that many economies may be delinked from global trends also relates to the marginal role of developing countries in the generation of technological knowledge. As a matter of fact, technological innovation continues to be the domain of industrialised countries. A first indication to this effect is that industrialised countries still received 98 per cent of worldwide non-financial property income in 1993, which mainly comprised royalties and license fees accruing to foreign owners of intangible assets (IMF various issues: Part 2, Table C13).[19] In contrast to their negligible share in worldwide receipts of non-financial property income, devel-

Table 3 – Distribution of Strategic Technology Alliances, 1980–1989

	Number	Percentage of alliances involving firms from		
		industrialised countries	industrialised and newly inustrialising countries	industrialised and other developing countries
Total	4192	95.7	2.3	1.5
Joint R&D	1752	99.1	0.5	0.4
R&D contracts, etc.	532	96.6	2.6	0.2
Joint ventures	1224	90.9	4.9	3.4

Source: Freeman and Hagedoorn (1994: 775).

oping countries transferred about 9 per cent of worldwide payments of property income to foreign owners of intangible assets in 1986–1993. Furthermore, so-called strategic technology alliances involving companies of different jurisdictions have been largely confined to OECD-based enterprises (Table 3). Especially joint R&D activities were almost exclusively pursued within the Triad of the EU, Japan and the United States. The participation of companies from newly industrialising and other developing countries was still below 10 per cent in the case of joint ventures.

Yet, these observations do not imply that most economies are excluded from technological progress. Not surprisingly, technologically motivated interfirm cooperation is mainly a business between equally advanced partners operating at the forefront of technological progress. Companies located in less advanced countries rarely provide for the required match of partners in this field of interfirm cooperation. Factor endowments typically prevailing in these countries prevent a stronger role in the *generation* of technological innovations. Put differently, strategic technology alliances are an inappropriate means to integrate developing countries into corporate globalisation strategies. Nonetheless, the Third World can derive benefits from transfers of technology. It is the *application* of internationally available technologies which matters most for developing economies. Instruments other than strategic alliances, notably international trade in capital goods and FDI flows, are better suited for transferring technology to these countries. The preceding assessment of FDI flows has indicated that the attractiveness of Third World economies for foreign capital is not determined by their minor role in producing new technologies, but rather by their capability to apply existing technologies. Consequently, fears appear to be largely unfounded that new manufacturing techniques will render it more difficult for developing countries to attract FDI in the future, which would increase the risk of falling further behind technologically advanced economies.[20]

Another question is whether developing economies receive technologies that fit their domestic factor endowments. What can be expected under conditions of globalisation is that newly industrialising economies should receive a higher share of sophisticated technologies than less advanced developing countries. Empirical evidence on the relative importance of so-called core technologies in international technological cooperation supports this proposition. Information technology, biotechnology and new materials, which are commonly considered to constitute the core of technological progress, clearly dominate strategic alliances and technology transfer agreements between OECD-based companies (Freeman and Hagedoorn 1994: 774). The share of these core technologies in technological cooperation involving companies from newly industrialising countries is considerably lower (about 50 per cent). Most interestingly though, about two thirds of all partnerships involving firms from less advanced developing countries are in areas other than core technologies. This pattern reveals that the focus of technological cooperation is related to factor endowments of the countries concerned. Hence, developing countries appear to be best prepared to participate successfully in globalisation and attract appropriate technologies if they specialise according to their comparative advantages.

IV. Developing Countries in the Era of Globalisation: Miracles and Dramas

The preceding evaluation has provided various clues as to a closer integration of developing countries into the international division of labour through trade and investment relations. The globalisation of production and markets seems to offer favourable chances for economic catching-up with industrialised countries. At the same time, it appears that various developing countries have failed to seize the opportunities involved in globalisation. After shortly portraying some failures and success stories, the subsequent section offers an explanation for the diverse economic performance within the Third World.

1. Recent Trends and Future Prospects

Closer trade and investment linkages have evolved for the Third World as a whole. All developing countries have nearly doubled their share in world exports of manufactures since the mid-1980s, to slightly less than 24 per cent in 1993 (Gundlach and Nunnenkamp 1996b: Table 1). According to data from the International Monetary Fund (IMF various issues), all (non-oil) developing countries attracted nearly 40 per cent of worldwide FDI flows in 1994. Table 4 shows that total exports of developing countries have grown faster during the last decade than their gross national product (GNP), while the expansion of FDI inflows still exceeded export growth by far. This is exactly what one could expect under conditions of enhanced involvement of developing countries in globalisation strategies.

However, developments for the Third World as a whole obscure remarkable differences between various country groups. Both indicators presented in Table 4 reveal that it is mainly East Asia which has become more integrated into the international division of labour.[21] By contrast, export expansion (relative to GNP growth) remained fairly low in Sub-Saharan Africa and turned out to be negative in Latin America as well as East Europe and Central Asia. Sub-Saharan Africa stands out insofar it is the only region for which FDI growth lagged behind export growth. The persistently low level of the FDI/exports ratio suggests that particularly Sub-Saharan Africa has not benefited from the trend towards globalised production so far. Nevertheless, Table 4 contradicts the widespread belief that only some newly industrialising economies in Asia take part in globalisation. The FDI/exports ratio supports the proposition that Latin America has restored its locational attractiveness for FDI after several countries in this region had implemented far-reaching economic reforms. At the same time, post-socialist countries in economic transition have emerged as new competitors for FDI.

Table 4 – The Integration of Third World Regions into the World Economy, 1985 and 1995 (per cent)

	Exports/GNP		FDI inflows (net)/exports	
	1985	1995[a]	1985	1995[a]
All developing countries	19.4	25.1	2.0	6.6
East Asia and Pacific	21.4	34.8	2.6	9.5
South Asia	9.3	15.8	0.6	3.0
Latin America and Caribbean	19.6	15.6	3.5	7.5
Sub-Saharan Africa	24.1	27.5	3.1	2.6
East Europe and Central Asia	19.7	13.7[b]	0.0	7.4[b]

[a]Preliminary. — [b]1994.

Source: World Bank (various issues).

Success and failure in becoming integrated into the worldwide division of labour are clearly mirrored by the highly diverse economic growth performance of developing country groups. East Asia and Sub-Saharan Africa again represent the opposite extremes, when comparing per capita GNP growth in 1985–1994 (World Bank 1996: Table 1): While the former region recorded an average annual growth rate of close to 7 per cent, per capita GNP declined in the latter region. Between these extremes, South Asia performed relatively well, whereas Latin America's "lost decade" is still reflected in low average annual growth of per capita GNP in 1985–1994.

Table 5 – Projections of Annual Average Growth in Per Capita GDP, 1994–2010 (per cent)

	Scenarios	
	Divergent	Convergent
China[a]	2.3	3.9
East Asia	3.0	4.4
South Asia	2.4	4.0
Latin America	1.4	3.3
Sub-Saharan Africa	–0.3	1.7
Former CMEA	0.9	3.5
OECD	1.6	2.3

[a]Including Hong Kong.

Source: World Bank (1995: Table 18.2).

Economic growth performance is expected to remain highly diverse under rather pessimistic assumptions (Table 5)[22]. The African malaise of declining per capita income is projected to continue well into the next century in the "divergent" scenario, which is one of muddling through and is largely based on persistence of past trends. According to this projection, income differences between developing country groups would widen further, and only the Asian region would continue the process of catching-up with OECD countries. Sub-Saharan Africa runs the risk of falling further behind even under conditions of strong policy action at the domestic level, combined with deeper international integration, which are assumptions underlying the "convergent" scenario. On the other hand, projections based on such optimistic assumptions suggest that all other countries and regions considered in Table 5 would achieve significantly higher per capita income growth than OECD countries. In any case, developing countries in Asia are expected to remain the economic powerhouse of the world economy. But economic growth in Latin America and former CMEA countries would come close to Asian standards.

2. The Role of Economic Policy

The strikingly different experience of developing countries in the era of globalisation raises the obvious question on the determinants of success and failure in becoming integrated into the international division of labour and achieving high economic growth. This paper cannot provide a comprehensive evaluation of this crucially important, but highly complex issue. Yet, some relevant insights may be gained by addressing major policy areas which are likely to play a decisive role under conditions of globalisation. The different and changing policy stance of governments may indeed explain, why the presumed "Asian Drama" turned out to be an "East Asian Miracle" (Myrdal 1967; World Bank 1993), why Latin America is recovering from the "lost decade", why the economic marginalisation of Sub-Saharan Africa may continue, and why post-socialist countries in Central and Eastern Europe are emerging as new competitors on world goods and capital markets.

As argued above (Sections II and III), exogenous factors such as the move towards regional integration, autonomous decisions by multinational corporations and technological developments cannot be blamed for the different performance of developing countries in the era of globalisation. This puts into perspective those domestic economic policies that shape the international competitiveness of rather immobile factors of production. Arguably, governments are no longer free to pursue economic policies of their own liking, unless they are prepared to delink their countries from worldwide trends. As it seems, there are no promising policy alternatives to striving for macroeconomic stability, encouraging investment in physical and human capital, and ensuring openness with regard to international trade and capital flows.

Macroeconomic stability, notably the absence of high and volatile rates of inflation, is the first indicator of a sound business environment. Excessive inflation results in higher investment risks and a misallocation of resources. Inflation is generally home-made, since budget deficits of the government are its main reason. This is most obvious when deficits are financed by printing money. Alternatively, high budget deficits will add to the tax burden of economic agents. Countries with pervasive inflation and budget deficits are, thus, relatively unattractive investment locations and are unlikely to experience strong economic growth in the longer run. It follows that the reputation for macroeconomic

stability which many Asian governments had established is at least partly responsible for the "Asian Miracle" of world market integration and economic catching-up. Developing countries in Asia as a whole reported an average annual inflation rate of about 9 per cent in 1985–1994 (IMF 1995: 120–123). This compares favourably with Africa (28 per cent), not to speak of Latin America (229 per cent) where various countries have suffered from hyperinflation until recently.

Second, more investment, induced by a stable macroeconomic environment, increases labour productivity and produces higher income in the long run. With regard to physical capital accumulation, East Asia displayed an outstanding performance among developing countries. In 1994, for example, gross domestic investment amounted to 36 per cent of GDP in this region (World Bank 1996: Table 13). South Asia, Latin America, and developing countries in Europe and Central Asia all reported investment rates somewhat above 20 per cent, whereas remarkably low investment in Sub-Saharan Africa (1994: 17 per cent) can be regarded as a major reason for this region's economic marginalisation.

Human capital formation is the third factor explaining success and failure of becoming involved in globalisation. Various studies suggest that this factor may be even more important in driving economic growth than physical capital accumulation (Barro 1991; Mankiw et al. 1992; Gundlach 1995). This tends to be all the more so in a globalising economy, given that the diffusion of new technologies is advanced by declining information and transaction costs, and that the application of such technologies depends on the availability of complementary local skills. Taking average years of schooling as a proxy of the stock of human capital, the sharp contrast between East Asia (1992: 6.5 years) and Sub-Saharan Africa (2.3 years) is again borne out (World Bank 1995: Table 18.1). As observed for the preceding indicators of the international competitiveness of rather immobile factors of production, other developing country groups rank in-between these extremes. Former CMEA countries are an exception; they come closest to OECD standards in terms of average years of schooling (8.2 versus 9.6 years). It thus appears that the integration of Central and Eastern Europe into the world economy is helped considerably by a comparatively favourable endowment with human capital.

All in all, the Asian success in becoming a most attractive location for international businesses is clearly related to a combination of short- and long-run factors which can be shaped by domestic economic policy. In other words, economic backwardness is not necessarily a permanent state of affairs. Macroeconomic stability is a matter of public budget discipline in the first place; the rate of investment is a question of business conditions, especially with respect to taxation; and the amount of compulsory formal education reflects the government's attitude towards the provision of public goods. Furthermore, recent empirical investigations reveal that openness in the form of largely unrestricted international trade and capital flows is of utmost importance for achieving high economic growth (Sachs and Warner 1995; Gundlach 1996). Openness eases the necessary technology import through imports of investment goods, FDI inflows and other forms of international investment cooperation. It promotes domestic competition and efficiency, and supports a closer integration into the world economy by shaping the production structure according to the respective comparative advantages of the economy.

Developing countries in Asia attracted substantial FDI inflows and emerged as the world economy's growth pole, since economic policy responded in a more appropriate way than elsewhere to the adjustment needs resulting from progressing globalisation. A priori, there is no reason why Asian-type success stories should not happen in other parts of the world. Various economies in Latin America and Central and Eastern Europe appear to be moving in this direction. Governments have increasingly accepted that globalisation implies fewer degrees of freedom for domestic policy-making. They have implemented macroeconomic stabilisation programmes and liberalised trade and FDI restrictions in order to reduce the risk of being delinked

from world goods and capital markets. This danger is still particularly pronounced in Sub-Saharan Africa, where many governments continue to be hesitant in embarking on consistent economic policy reforms.

V. Industrialised Countries under Adjustment Pressure

Both theoretical reasoning and empirical evidence suggest that the emergence of new competitors on world goods and capital markets gives rise to substantial adjustment needs in industrialised countries. The progressing integration of developing countries and transition economies into the international division of labour has confronted the Triad of the EU, Japan and the United States with similar challenges. Nevertheless, the labour market implications of globalisation have been strikingly diverse, and the members of the Triad have responded in different ways to the challenge of globalisation.

1. Unemployment in the Triad: Stylised Facts

The rate of unemployment surpassed 11 per cent in the EU in 1994, although a significant economic growth stimulus was widely expected to result from the completion of the Internal Market programme. Currently, hardly anyone expects labour market conditions to improve considerably in the foreseeable future. All major EU countries experienced a rise in unemployment from 1974–1982 to 1983–1994, when comparing period averages of standardised OECD data on unemployment (Table 6).[23] The average of the standardised rate of unemployment for seven EU members[24] went up from 2.9 per cent in 1973 to 9.7 per cent in 1994. Nothing comparable happened in Japan and the United States. US unemployment had traditionally been higher than unemployment in the EU, mainly because of significant frictional unemployment, but the standardised rate increased only modestly after 1973. The discrepancy is even more pronounced when comparing the EU with Japan, where the rate of unemployment remained below 3 per cent until 1994.

Theory suggests that globalisation affects low-skilled labour in OECD countries in the first place (Section I). As a matter of fact, labour demand has shifted to the disadvantage of low-skilled labour section since the early 1980s (Paqué 1996). Unemployment of low-skilled workers increased disproportionally in EU countries, whereas the ratio of unemployment rates between high-skilled and low-skilled workers remained roughly constant in the United States. A similar pattern prevails with regard to long-term unemployment, which is frequently considered a proxy for unemployment at the lower end of the spectrum of qualifications. The share of long-term unemployment in total unemployment is exceptionally high in EU countries, as compared with both Japan and the United States (Table 6). This points to a dualisation of EU labour markets. Furthermore, the share of youth unemployment in total unemployment increased significantly in EU countries such as France and Italy, whereas it did not change much in Japan and the United States (Gundlach and Nunnenkamp 1996a: Figure 2).

The unfavourable unemployment record of the EU was associated with less employment generation than elsewhere in the Triad. The Netherlands are the only exception in this respect. For the remaining six EU countries listed in Table 6, average annual employment growth in 1983–1993 (0.6 per cent) was only half the employment growth in Japan, and about a third of employment growth in the United States.

Table 6 – Unemployment and Changes in Employment in the Triad (per cent)

	Unemployment rate[a]		Share of long-term unemployment in total unemployment[b]	Average annual change in employment
	1973	1994	1993	1983–93
Belgium	2.7	9.7	53	0.7
Denmark	0.9	10.1	34	0.7
France	2.7	12.5	34	0.3
Germany (West)	0.8	6.9	40	0.9
Italy	6.2	12.0	58	0.5[c]
Netherlands	3.9	7.2	52	3.2[c]
United Kingdom	3.0	9.6	43	0.6
EU average[d]	2.9	9.7	45	1.0
Japan	1.3	2.9	17	1.2
United States	4.8	6.0	12	1.7

[a]Standardised rate according to OECD procedures. — [b]12 months and more. — [c]1983–1992. — [d]Seven countries listed; unweighted mean.

Source: OECD (various issues).

2. Adjustment Strategies: The Role of Wages and Structural Change

The strikingly diverse labour market outcomes strongly suggest that the members of the Triad have reacted differently to the common challenge of globalisation. Collective wage bargaining is the first candidate in this respect. Evidence on the distribution of earnings within the economies under consideration indeed helps to explain the puzzling unemployment patterns. The dispersion in earnings widened considerably in the United States and, though to a lesser extent, also in Japan (OECD various issues). Low-paid workers, which can be assumed to represent the lower end of the spectrum of labour qualifications, suffered a decline in their real wages in the United States, while high-paid (i.e., high-skilled) workers benefited from above-average wage increases. More pronounced wage dispersion in the United States was probably supported by decentralised wage bargaining and modest unemployment support. In sharp contrast, in most of continental Europe, more generous unemployment support schemes and fairly centralised collective wage bargaining worked against greater wage dispersion. Consequently, the wages of low-paid workers rose in line with mean earnings, or even improved relative to the mean (Gundlach and Nunnenkamp 1996a: Figure 3). This leads to the conclusion that high unemployment, especially of low-skilled labour, is the price that EU countries had to pay for insufficient relative wage flexibility.

Changes in the structure of employment in manufacturing further support the proposition that EU wage policies were inappropriate to deal with the challenge of globalisation. The EU experienced a drastic cut in employment, for example, in the textile and clothing industry. This relatively labour-intensive industry suffered a decline in relative world market prices, as compared with world market prices of more (physical and human) capital intensive goods, which is in line with theoretical predictions outlined in Section I.[25] Nevertheless, the United States prevented a significant reduction of employment in textiles and clothing. Compared with the EU, the development of relative wages was more in line with the development of relative world market prices.

At the same time, employment creation in more skill-intensive industries (e.g., in manufacturing of automobiles) remained small in the EU as compared with Japan. Trade data underscore that, within the Triad, structural change has been most pronounced in Japan. Measured by world export shares for manufactures, the EU

was clearly outperformed by Japan (and also by the United States).[26] More interestingly though, the development of world export shares differed tremendously across manufacturing industries in the case of Japan, whereas the pattern was rather uniform in the case of the EU. The decline in the EU's export shares was of similar magnitude in industries characterised by quite different factor intensities. For example, the physical capital intensive chemical industry as well as the labour intensive textile and clothing industry lost about three per centage points in world export shares. The loss was somewhat more pronounced in the production of machinery and transport equipment; advanced EU economies should possess comparative advantages in this industry which is relatively human capital intensive on average, although factor intensities vary considerably within this broadly defined industry. In the case of Japan, the change in world export shares for manufacturing as a whole obscures significant variation at the industry level: Labour intensive and standardised lines of production such as clothing and textiles, metal products, and iron and steel reported considerably lower export shares in 1993 than in 1980. On the other hand, machinery and transport equipment recorded an increase in export shares of twice the manufacturing average. The restructuring of exports indicates that Japan was more successful than the EU in specialising according to its comparative advantages.

All in all, labour market developments are in line with the proposition of an increasing globalisation of production and markets. This is not to ignore that other explanations such as (low-skilled) labour-saving technological progress are also compatible with empirical facts.[27] However, technological change itself may be driven to a significant extent by the trend towards globalisation. That is, globalisation impairs the wage and employment prospects of low-skilled labour in advanced economies either directly or indirectly through technological change. As it seems, the ensuing adjustment needs, in terms of wage flexibility and structural change, have been handled most effectively in Japan, where economy-wide employment problems were largely avoided. US labour markets have responded to fiercer worldwide competition by remarkably flexible wage policies, whereas restructuring towards skill-intensive manufacturing remains a matter of concern. In the EU, adjustment has remained sluggish in terms of both wage differentiation and structural change.

3. Policy Options Ahead

Economic policy-makers in advanced economies are facing a major dilemma in the era of globalisation. The implication of enterprises having more options to realise cost savings and exploit profit chances at a worldwide scale is that government autonomy in economic policy-making is shrinking. In particular, the effectiveness of traditional means to protect non-competitive factors of production is eroded. The protection of low-skilled workers through restrictions imposed on labour-intensive imports is undermined because trade barriers may be circumvented by relocating production. Furthermore, the higher mobility of capital and the easier access to technology enable new competitors to upgrade their exports.

It is thus not surprising that it is heavily debated in industrialised countries, notably in the EU, in which way governments can contribute to combating unemployment and ensuring technological leadership. The limited effectiveness of conventional protectionist measures has fuelled demands for more sophisticated protection. The request for a multilateral harmonisation of standards with respect to social and ecological production conditions is most noteworthy in this respect. Common production standards would impede the catching-up process of lower income economies if these countries were required to adhere to the demanding social and ecological standards of industrialised economies. This would ease the adjustment burden of ailing industries, but only at the cost of technologically more advanced industries. The latter would suffer from lower demand for their products in emerging markets and from upgrading of exports by new competitors, if locational characteristics were denied their role in shaping the international division of labour. In essence, inno-

vative protectionist measures resemble traditional means: They lead to allocative inefficiency and structural rigidity in the protected economy, while the incentives to increase productivity through technological innovation are weakened.

Strategic industrial policy is frequently considered another option to tackle unemployment and insufficient innovativeness. While the drawbacks of persistent subsidies granted to ailing industries are well-known, the more recent EU experience with industrial targeting at high-tech industries is not encouraging either. Frequently, huge fiscal outlays failed to produce a significantly improved world market performance of the promoted industries; examples include the European aircraft industry and the production of semi-conductors. Arguably, the assumption underlying the EU approach, namely that the competitive strength of Japanese companies is because they are enjoying the advantages of an unlevelled playing field, rather than being the better players, is not valid. In any case, strategic industrial policy is inherently flawed for various reasons: Governments face serious constraints in picking winners, i.e., identifying future growth industries; the targeting of support schemes on domestic enterprises becomes increasingly difficult under conditions of progressing interfirm cooperation at a global scale; lobbying by large companies is encouraged, whereas small innovative enterprises may suffer from discrimination; and retaliation by foreign trading partners is highly likely.

In the short run, there seems to be no alternative but to accept that the trade-off between employment and wages has become more pronounced in the era of globalisation. The US example shows that employment of low-skilled workers can be maintained if relative wages are flexible. Hence, trade unions, especially in the EU, have to agree to wage flexibility and wage differentiation. Governments have to provide appropriate incentives for employment-enhancing collective wage bargaining. This may require generous unemployment benefits to be revised to the extent that they discourage workers to accept lower paid jobs. It should be noted, however, that flexible wage policies cannot halt globalisation and the ensuing devaluation of low-skilled labour in advanced economies. They only offer a cushion until a longer term strategy becomes effective.

From low-skilled labour being the major problem in advanced economies, it follows that a strategy of tackling the causes of impaired competitiveness must focus on human capital formation. Industrialised countries have little choice but to strengthen their comparative advantage in skill-intensive sectors by improving the qualification of the workforce. As globalisation implies a permanent change of job requirements, human capital has to be built in a way that allows for flexibility and mobility of the workforce. To this effect, the curricula of schools and universities may have to be reviewed in cooperation with the business sector, in order to narrow the gap between the skills supplied and those required in labour markets. Likewise, existing systems of vocational training, including the widely admired German apprenticeship system, may have to be revised, taking into account that the life-cycle of vocational skills is shortened with proceeding globalisation. Probably, there will be an increasing demand for flexible generalists rather than narrow specialists.

Specific training of the workforce may be left to the market, but governments have a major role to play in supporting human capital formation (for example, by taxing consumption rather than savings). A bigger stock of skilled labour delivers social benefits in terms of greater flexibility in responding to economic change. Reforms of the system of education and training are likely to take considerable time to enhance the competitive position in skill-intensive sectors. It is exactly because of these time lags that such reforms must not be postponed.

VI. Summary

A more advanced international division of labour offers vast opportunities to raise economic welfare on a worldwide scale. Foreign trade allows for specialisation according to the trading partners' respective comparative advantages. Cross-border mobility of capital and technology renders it possible for enterprises to slice up the value chain, i.e., to achieve a geographically dispersed fragmentation of production. It is the major characteristic of economic globalisation that the international division of labour is pushed forward by both mechanisms at the same time. Yet, globalisation is not only instrumental to raising world income, but also gives rise to distributional conflicts. In the national realm, the relatively scarce factors of production face mounting adjustment pressure once the locational decisions of enterprises are no longer constrained by segmented goods and factor markets. Internationally, welfare gains tend to be unevenly distributed; various countries may be badly prepared to meet the challenge of fiercer competition, especially with respect to capital and technology inflows. Two issues figure prominently in the current debate on the opportunities and risks involved in globalisation. The first question concerns the prospects of low-income countries to become involved in globalisation and catch up economically with industrialised countries. Furthermore, the discussion centres around the labour market implications of globalisation in industrialised countries, notably on its impact on low-skilled workers.

Various arguments have been raised against the proposition that globalisation amplifies adjustment pressure for industrialised countries and offers better opportunities for developing countries to derive economic benefits from a more sophisticated division of labour. First, income gains resulting from multilateral trade liberalisation agreed upon in the Uruguay Round have been shown to be concentrated on OECD countries. Income gains are mainly due to the countries' own liberalisation measures, rather than better access to foreign markets. This implies that developing countries could have increased their share in worldwide welfare gains if they had committed themselves more strongly towards multilaterally binding trade liberalisation. In any case, multilateral trade liberalisation represents a "win-win strategy" with only a few possible exceptions in the short run. The neomercantilist approach adopted by various governments is thus grossly mistaken from a macroeconomic point of view, while it may support the vested interests of pressure groups.

Second, the revival of regionalism may suggest that the international division of labour is progressing at a regional rather than at a global scale. Countries remaining outside major integration schemes would then run the risk of being excluded from closer trade and investment relations. Empirical evidence on trade and FDI patterns is largely in conflict with this contention. Regionalism, though important, is not the dominant feature in the world economy. Closer trade linkages have emerged both regionally and globally. Asia's favourable world market performance indicates that membership in, and privileged market access to major integration schemes matter less than domestic economic policies for explaining successful participation in international trade. Likewise, various countries have emerged as most attractive locations for foreign investors, although institutionalised ties with either the EU or NAFTA were largely lacking.

Third, the chances that low-income countries could induce catching-up processes would be impaired if cross-border mobility of capital had remained limited and FDI inflows were concentrated on a few fairly advanced economies. As a matter of fact, capital owners reveal a home country bias, but this bias has become less pronounced since the 1970s. As concerns the distribution of FDI, developing countries have increased their share considerably, notably in the early 1990s. Furthermore, the frequently noted concentration of FDI on some major Third World hosts tends to underrate the chances of newcomers to derive economic benefits from globalisation through attracting FDI. The coun-

try composition of the group of major recipients of FDI has changed over time, depending on the local investment climate and the underlying economic policies. At the same time, various small economies have succeeded in attracting fairly high per capita inflows of FDI.

Fourth, low-income countries are sometimes believed to end up in a poverty trap if they specialise in labour-intensive and highly standardised lines of production. However, the fact that these countries are hardly involved in the generation of technological innovations does not imply that they are delinked from technological progress. Rather, imports of capital goods and FDI inflows represent promising means to gain access to internationally available technologies. Low-income countries are best prepared to receive and apply appropriate technologies if they specialise according to their comparative advantages.

From all this it follows that neither foreign trade nor international capital and technology transfers are a zero-sum game. The emergence of promising markets and new competitors for foreign capital supports trade creation and additional investment opportunities. Empirical evidence strongly suggests that developing countries have indeed achieved a closer integration into the worldwide division of labour through trade and investment relations. However, the economic performance of different groups of Third World countries has remained strikingly diverse, with the "Asian Miracle" and the economic marginalisation of Sub-Saharan Africa representing the opposite extremes. Exogenous factors such as the move towards regional integration, autonomous locational decisions by multinational corporations and technological developments cannot be blamed for success and failure in benefiting from globalisation. Rather, a close link exists between economic performance and domestic economic policies that shape the business environment prevailing in different locations. Governments are no longer free to pursue economic policies of their own liking. In order to become involved in globalisation, there is little choice but to ensure macroeconomic stability, encourage physical and human capital formation, and open up towards foreign trade and capital inflows.

In principle, Asian-type success stories may also happen in other parts of the world. The chances for this to occur have improved since many governments in Latin America and Central and Eastern Europe have embarked on comprehensive stabilisation and liberalisation programmes. This is likely to confront the Triad of the EU, Japan and the United States with even more pressing adjustment needs than experienced in the recent past already. Labour market developments in the Triad support the proposition that globalisation affects low-skilled labour in the first place, either directly or indirectly through technological progress. The leading industrialised economies have reacted differently to the common challenge of globalisation. The need for structural change in production and export patterns seems to have been handled most effectively in Japan. US labour markets have responded to fiercer worldwide competition by remarkably flexible wage policies. In the EU, particularly high unemployment — especially of low-skilled workers — appears to be the price that had to be paid for sluggish adjustment in terms of wage differentiation and structural change.

Industrialised countries should realise that the effectiveness of traditional means to protect non-competitive factors of production is eroded in the era of globalisation. Moreover, protectionist innovations as well as strategic industrial policy do not provide reasonable alternatives with which to tackle unemployment and insufficient innovativeness. Wage flexibility does buy some time for structural adjustment but cannot halt globalisation and the ensuing devaluation of low-skilled labour in advanced economies. Hence, industrialised countries have little choice but to promote human capital formation in order to strengthen their comparative advantage in skill-intensive lines of production.

Endnotes

1 For the theoretical framework underlying this interpretation, see Leamer (1992).

2 The current account mirrors the difference between savings and investment of an economy. Hence, net trade flows and net physical capital flows are two sides of the same coin.

3 Such concerns are discussed by Bergsman and Lall (1995) and OECD (1996).

4 For a more detailed discussion of the Uruguay Round results, see Langhammer (1994).

5 Recent examples include the struggle over better market access of US producers in Japan and EU complaints about allegedly subsidised steel exports of the Czech Republic.

6 According to WTO data, commercial services accounted for 21 percent of worldwide trade in goods and services in 1994; for further information, see WTO (1995).

7 For a summary, see Langhammer (1996); see also Langhammer (1994) and Martin and Winters (1995).

8 It fits into this picture that developing countries gain more than industrialised countries, if the assessment of the Uruguay Round is restricted to liberalisation of trade in manufactures (Harrison et al. 1995: 37). Traditionally, protection of manufacturing industries has been lower in industrialised countries than in developing countries.

9 EU preferences are granted in the context of several free trade agreements, through a wide range of association and co-operation agreements (including the Lomé Convention), and within the generalised system of preferences (GSP); for details, see Hiemenz et al. (1994: 10 ff.).

10 Most notably, the far-reaching agreement of 1991 to establish a common market comprising Argentina, Brazil, Paraguay and Uruguay (MERCOSUR) by the end of 1994 has had little impact on trade patterns so far. The share of imports from MERCOSUR members in total imports of Argentina and Brazil, for example, increased only marginally in 1990-1994; for details, see Foders (1996). It remains to be seen whether intra-MERCOSUR trade becomes more important once the common market, which includes a common external tariff, is in full operation.

11 Several authors argue, however, that various Caribbean and Asian economies may be affected negatively by the erosion of tariff preferences, which they traditionally enjoyed on US markets relative to Mexico, and by NAFTA's restrictive rules of origin; see, e.g., Langhammer (1992: 17) and Bouzas (1995: 16).

12 For a more detailed assessment, see Gundlach and Nunnenkamp (1996b).

13 This rather surprising finding became known as the Feldstein-Horioka Puzzle (Feldstein and Horioka 1980).

14 The correlation coefficient between savings and investment rates declined from more than 0.8 in the 1960s to about 0.6 in the 1980s (Feldstein 1994: 15).

15 For a more detailed analysis, see Agarwal et al. (1995).

16 This group comprises China, the four Asian NIEs and ASEAN(4); see notes to Table 2.

17 This follows from information provided in Wallraf (1996: 19) and UNCTAD (1995b).

18 The share of developing countries in worldwide FDI outflows increased from less than 6 percent in 1983–1988 to nearly 15 percent in 1994 (UNCTAD 1995b: Annex Table 2).

19 For the limitations of this proxy, see Nunnenkamp et al. (1994: 38 ff.).

20 For an opposing view, see Freeman and Hagedoorn (1994: 779).

21 The interpretation of the exports/GNP ratio has to be restricted to its development over time. The comparison across country groups is not meaningful, because this ratio tends to be systematically lower for large economies.

22 For a more detailed presentation of different scenarios and their implications, see World Bank (1995: Section 18).

23 Statistical information in the following paragraphs is largely from Paqué (1996) and Gundlach and Nunnenkamp (1996a).

24 Comparable data are missing for other EU countries.

25 For a more detailed analysis, see Gundlach and Nunnenkamp (1996a).

26 Excluding intra-EU trade, the EU's share in world exports of manufactures declined by nearly 5 percentage points since 1980, to 17.5 percent in 1993. The loss in market shares remained modest for the United States (0.8 percentage points), while Japan raised its market share from 10.8 percent in 1980 to 12.7 percent in 1993 (own calculations based on UN 1995).

27 On the relevance of trade and technological progress for determining labour market outcomes, see Krugman and Lawrence (1994), Lawrence and Slaughter (1993) and Wood (1994).

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