"EU expansion and the strategies of multinational enterprises: a comparative analysis with the east asian and north american continental integration processes"

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EU EXPANSION AND THE STRATEGIES OF MULTINATIONAL ENTERPRISES: A COMPARATIVE ANALYSIS WITH THE EAST ASIAN AND NORTH AMERICAN CONTINENTAL INTEGRATION PROCESSES

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1. Introduction

Our objective in this paper is to analyze the main underlying microeconomic driving forces that have shaped the European integration process in a comparative perspective. Through both an economic history and political economy perspective, we will highlight the existence of two separate stages in this process of integration (one of the earliest experience of continental integration, beginning just after WWII while the other ones will begin only during the mid 1980s). We will investigate both the political dimension of integration (the choice of nation-states to transfer parts of their sovereignty to supranational bodies) and its economic side (which is consubstantial to the first dimension, as the European political process of integration was in a sense motivated and implemented on economic grounds). In our analysis economic constraints receive special attention, and are viewed as determinant. This is also why we focus on the strategies of the multinational enterprises (MNEs) and on the policies set up and put forward by the various Member States and the Commission to foster their development. We implicitly assume that both the Member States and the Commission pursue a kind of neo-mercantilist agenda or a neo-Listian one (De Meulemeester and Defraigne, 2008), i.e. the desire to maximize the political power of the entities they are in charge of through the fostering of their economic strength, the latter being attained by supporting the main actors of economic growth – the biggest firms (the only ones possessing a sufficient lobbying power to influence the decision-making process). The evolutionary historical analysis will enable us to better pinpoint the specific characteristics of the European integration process (and its likely future evolution).

This contribution will highlight the different underlying microeconomic driving forces behind regional integration in Europe, North America and East Asia. The first driving force that affects the European integration process from the late 1950s to the beginning of the 1990s is the search of economies of scale in order to enable the largest European firms to fully benefit from Fordist mass standardized production methods, thereby resisting better to their US competitors. This necessitated the building of an integrated market with homogeneous consumers that were characterized by a relatively low degree of disparity in standard of living. From the mid 1980s until the present time, Europe, but also East Asia and North America, have been experiencing a second type of driving microeconomic force that fosters and shapes these regional integration processes. This integrating force is generated by the regionalization of the production (RPP) process of the MNEs. Contrary to the first driving force, this contribution will show that the RPP of MNEs generates a regional integration process that is based on the inclusion of national economies with very different economic development level and different institutions. This bears serious consequences on the future economic and social cohesion in Europe and the sustainability of the European social model and of the functioning of its supranational institutions.

2. Analysis of the stages of the European economic integration process as a response to changing microeconomic constraints

2.1. The first (failed) attempt at European unification: the German imperial domination attempts

Several authors (Defraigne, 2004; Mazower, 1998, Mazower, 2008) have tried to interpret the economic and political European history during the 20th century as the slow awareness by
the political and economic elites (especially in Germany, the emerging new continental power) that « size matters1 ». The success of the American model (already perceptible before WW1) and especially American firms was viewed as partly due to the large market size available to them (large unified market since the 60s of the 19th century and growing population linked with the massive migration from Europe). The insufficient size of European national markets (for our discussion: of the German one) impeded European (and first of all German) firms to rival optimally with their US counterparts and benefit from scale economies.

In an international context marked at the end of the 19th century by limitations to free trade (see the German tariff of 1879; the French Méline tariff of 1892), Germany – one of the most dynamic economies with a series of very successful firms based upon the technologies of the second Industrial revolution – suffered from the limitations of its national market size and of its colonial empire (5 times less populated than Germany itself) (Beaud, 1985). Even if German products were competitive (e.g. in the UK, with reactions as the campaign « buy British ! »), even if the Austro-Hungarian, Balkan and Ottoman markets were Germany’s chasse gardée, the rising protectionist trend and its limited national markets were severely felt, and viewed as hindrance to the German economic strength (Wilkins 1970, Defraigne 2004; Beaud, 1985; Hagen, 1999). Even by adding the various captive markets to the Reich’s one, those markets were too limited to allow German firms to operate at the optimal scale level in numerous strategic sectors.

As a reaction, a series of Pangermanic associations2 (even if marginal, they had a strong influence on the élites as they appear as a response to real economic constraints) propagated a message towards the unification of German-speaking and even more largely Germanic (Dutch, Scandinavian…)-speaking countries, coupled with the idea of Germanic superiority allowing the conquest and domination of less developed areas in Europe or in the World. The idea of a large MittelEuropa dominated by Germany received considerable appeal and influenced the definition of the war aims of Imperial Germany during WW13. These expansionist currents could be viewed as an economic response to specific German constraints if the country wanted to keep its position in the world (in a time when market size did matter for industries to reach optimal, i.e. cost-minimizing, size). The coalition of interests between old-fashioned aristocratic establishment (inter alia in the army) and the new capitalists can be understood in this light. The first German attempt to take over the continent (the clauses of the Brest-Litowk treaty in 1918 could give us a glimpse of what a German-dominated Europe would have been) ended up in complete failure (partly due to the American economic superiority, the latter gave to the Western allies in 1917-18 the decisive strength to defeat Germany).

Even if defeated, submitted to reparations, partly occupied and cut off from some of its more prosperous or agricultural parts (Alsace, Lorraine, Posnania…), Germany remained after WW1 the central economy of Europe (as perfectly understood by Keynes, 1920, who advocated a mild treatment of Germany for European prosperity’s sake) (Keynes, 1920). After the hyperinflation of 1923, the German economy revived for a short while, but the economic crisis of 1929 and its aftermath hit it directly. The withdrawal of American capital coupled with a financial, banking and industrial crisis shook the German society. As Germany was made a democracy in 1919, the economic losers could now vote for extreme political parties on the left and the right (Frey, 1994). The combination of extreme nationalism and a political agenda that appeared social in a time when the political parties all shared conventional laisser-faire policies attracted increasing portion of the votes to the Nazi

1 For an economic analysis of this topic through the lens of contemporary neo-classical economics see Alesina and Spolaore (2003).
2 See Korinman, 1999 for a survey on the Pangermanist movement. See also J. Droz (1960)
party. Hitler was nominated chancellor in January 1933 and took power in March 1933. Even if one side the Nazi programme was deeply irrational (with its racist obsession), on the economic side it was in line with a long run trend in German economic discourse (and the pangermanist agenda before WW1). In a context of increasing protectionism, the German economy suffered from the limited size of its internal market and its limited resources. If the country wanted to remain (or attain the status) of a global power, it had to dominate a much bigger territory and population (i.e. market size) than the current German territory. For the largest German firms (konzerne), they could rival with their American counterparts only if they could rely to a sufficiently large market (Chandler, 1994 & Mazower, 1998). Again, there was a convergence of interests between the Nazi political elite and the German industrial capitalists (the more so that the conquest of a German empire meant also huge outlets for the armament industry). The game was risky (both globally as the odds of winning a war were not that big for Germany at the onset of the war, and internally, as the Nazi régime tended towards a more dirigiste approach of the capitalist economy\(^4\)), but between 1940 and 1942 Germany could hope that the war could be won. Some members of the German economic and political elite, dreamt first of an integration of all Germanic people (integration of Dutch and Scandinavian volunteers in the Waffen SS; idea of merging the Dutch, Scandinavian and German bourgeoisie through the cross participation in the capital of their respective big firms (Milward, 1987), and since 1942 of a continental integration (even if with a clear racial hierarchy). This project was at the same time (as in 1914) too ambitious for a middle-sized country as Germany and completely at odd with the rough exploitation of the continent by Nazi Germany (whose Führer was never in favour of sharing German power – see Mazower, 2008). The combination of ruthless occupation (imperialism inside Europe, see Mazower, 2008) and terrible crimes against mankind ruined the project of a unified Europe with Germany as its Piedmont. The defeat of Germany in 1945, the Soviet occupation of Berlin, Prague and Vienna, the rise of the communist parties all over Europe led the American administration to design strategies in order to stabilize Western Europe politically (to contain the rise of communism) by increasing its prosperity (and first of all ensuring the reconstruction) through reconciliation and integration.

2.2. The first stage of the economic integration process corresponding to a specific microeconomic logic: to build an integrated market for goods and services in order to allow European firms to benefit from scale economies due to market size

In order to fight back communism, to favour economic growth and impede new wars between European nations, the American administration after WW2 acted proactively in favour of the establishment of United States of Europe with an European federal government (see Ellwood, 1992; Djelic, 1995; Hogan, 1989; Winand, 1995). Jean Monnet was for example the proponent of an European message very close to the American model and with strong private links with key US figures like the Dulles family (Djelic, 1997 & Ellwood, 1992). One step was the Marshall Plan (from 1947 to 1952) with the concomitant foundation of an institution to administer it, later on called OECD. Another step was the ECSC (common market for coal and steel – key sectors at the time for the armament industry), just 5 years after WW2. The ECSC was an international organization with very important powers (the High Authority), able to guide restructuring of these two industries from above. The international context of the time was the one of « Cold War » with a strong confrontation with an expanding communist Soviet Union, powerful communist parties even in the West – linked also with the material situation (hunger in Germany in 1947-48, «rationnement» in France…) (Messenger, 2006; Kolko, 1994; Fontaine, 1983). Reconstruction and economic prosperity became key political priorities in order to reduce the attraction of the communist parties and show the economic superiority of capitalism.

\(^4\) Germany even introduced during WW2 several elements of the Welfare state as state pensions, or free higher education (funded through the occupation of Europe). See Aly Götz (2007).
On top of that, and more fundamentally, the economic problems that European capitalism faced during the first half of the 20th century remained: fragmented national markets too small to allow firms to benefit fully from scale economies (with the linked cost disadvantage vis-à-vis American firms). As the violent unification of markets through political domination was no longer an option (and did not seem to have worked well anyway), there were strong forces below the surface pushing the economic élites of the various European countries to go beyond strict national cleavages. Cooperation appears (also among German economic élites) more promising than conflict. These elements foster the setting up of supranational institutions. The American authorities are well aware of this problem of the narrowness of each national market in Europe which was too small to enable European firms to benefit from the full effect of the standardized Fordist mass production system. The experts were convinced that only this switch could allow the largest European firms to increase their productivity and the wages paid to the workers. The latter increase of the purchasing power could lead to the mass consumption society and the « American way of life » as an alternative to the Soviet model (Djelic, 1998). The building of an European unified market and the setting up of supranational institutions were clear policy objectives of the American administration during the Cold War (Ellwood, 1992 ; Hogan, 1989). The American administration fostered as much as it could the European integration process up to the 50s, playing a role of arbiter between the different national élites of Europe and trying to convince them of the benefits of the sovereignty transfers to those newly established European supranational institutions.

The political context changed after the death of Stalin in 1953 (even if some events troubled the geopolitical thaw: the 17 June 1953 riots in Eastern Germany, the Poznan riots in 1956 and the events of Budapest in 1956). The conflict with the Soviet Union became less acute (see the contacts and agreements on the transfer of the last German war prisoners between Adenauer and the Soviet Union), the strength of communist parties in the West declined in parallel with the booming economies (Wirtschaftswunder in Germany). In this context, the Americans played less their role of active advocates of the European integration. The political approach failed (the European Defence Community was rejected by France in 1954). Europe became more independent from the US – especially those colonial powers as France or the UK (both intervening in Egypt in 1956 – but having to retreat following the joint pressure of USA and USSR) and each country more autonomous (the Soviet threat appeared less pronounced while France for example was mainly concerned by its internal problems and the Algerian war). There was a clear rise in intra-European trade but it remained impeded by numerous tariff and non-tariff barriers (Defraigne, 2008). This is the context characterizing the birth of the European institutions that we still know today. The building of a European Economic Community (EEC) aimed less at building supranational political organizations than creating a unified (common) market benefitting all the Member-States and their firms. In a context of more marked national rivalries, the logic of the ECSC was extended to the other goods and services, but with less supranational powers than the High Authority. The Treaty of Rome is signed in 1957, following a process launched at the conference of Messina (1955). Six European countries (Benelux States, France, Germany and Italy) decided to build a Common Market – in practice they first built a Custom Union (free trade for goods and services and a common external tariff). They reduced first their tariff barrier (up to 1968) and their non-tariff barrier afterwards. Common policies are also set up (among them the Common Agricultural Policy launched in 1963 – which is a kind of protectionism and interventionism). The CAP, with its system of external tariffs and subsidies, its maximum and minimum prices and stabilization stocks was at odds with a free market philosophy. But it was a success in terms of its stated objectives (European self-sufficiency; structural adjustment of the sector favouring big industrialized farms and big producers).

In this framework (the EC with the 6 founding member-states), even if Germany was a dominant Member in the zone, it was not to the point of being in such an asymmetric position (e.g. vis-à-vis France) as similar dominant nation in other areas, e.g. as USA in the North American area or Japan in East Asia (see Table I). The first European model was also rather
homogenous both in terms of standard of living, social model and economic development (at
the possible exception of Southern Italy, but several policies were carried out in order to
ensure the convergence of Mezzogiorno towards the level of Central-Europe, i.e. Benelux,
Rhineland, Paris and Northern Italy). It was characterized by a specific type of capitalism –
the « Rhineland model » to quote Michel Albert (1996) (« mix social economy ») – with as
key characteristics the Fordist model, mass production coupled with mass consumption
ensured by stable labour relations and higher wages ensured by increased productivity, a
Keynesian macroeconomic management, a relatively ‘closed’ economy – open only to
countries with similar levels of development and similar industrial structures, a key role of
trade unions negotiating with employers representatives the sharing of productivity gains
(ensuring by the way social stability – see the Mitbestimmung model in Germany), welfare
state with relatively high tax rates, low inequality, and a specific role of banks – rather than
financial markets – to finance the economy… In this philosophy of the European integration,
cohesiveness and reduction of disparities were clear objectives. Similarity and homogeneity
of the Member States were not solely given characteristics at the beginning of the process; it
was also the aim of this first European model to ensure stability and homogeneity through
several policy devices as the CAP or the various fixed exchange rates mechanisms
(international as Bretton Woods up to 1971, European as the European Monetary System
from 1979 onwards), and the role of structural funds. Stability and social and interregional
cohesiveness were key characteristics of the first stage of economic integration. The stated
objective (in the Treaty of Rome) to create a common market was viewed as beneficial for all
member-states (still viewing economic challenges in a national perspective, e.g. supporting
« national champions »), and the main idea was still to benefit from scale economies through
the creation of an integrated European market comparable in size to the US market.

In this first stage (1957-1973), the EEC will face unparallel growth rates (the Golden Sixties)
even if this growth was not so particularly labour-intensive) as well as a growing inter-
European trade (the tariffs being abolished as up to 1968 – even if lots of non-tariff barriers
remained). The next decade will introduce much more turbulence (end of the Bretton Woods
system in 1971, flexible exchange rates, rise of oil prices following the Israeli-Arabic
conflict in October 1973) at the international level, while the steady growth of inter-European trade
faced its limits. The European countries and the EEC tried to respond to these challenges
through various devices aiming at restoring stability (if the Werner plan of 1970 failed, the
member states nevertheless tried to restore an island of stability in a world of instability – first
with the « European monetary snake » from 1972 to 1979, then with the EMS since 1979).
With the economic slowdown (coupled if not linked to the rising oil prices), the rising
international competitiveness of Asian countries (Japan first of all) in traditional European
industrial sectors (leading to rising unemployment), the weakness in terms of size of the
European MNEs was still more evident. During the seventies the Fordist model also reached
its limits (Boyer, 1998 & Oman, 1994).

With wealthier consumers (in comparison with the 50s or 60s), demands became more
complex. Furthermore, the rising international competition in the 1970s, especially from the
emerging countries, which could produce more competitively mass standardized products
began more problematic for the Western firms. The firms from the most advanced
economies had to respond by differentiating their products (to create new and better
products), leading to higher costs in R&D (also to improve the production chain, making
them more multi-products and flexible through the use of robotics and computers) (Boyer,
1998 & Defraigne 2008). On top of that, expenditures on marketing and advertising were
also on the rise. All these evolutions still increased the minimal optimal size of the firms (due
to increased fixed costs) – and the moderately-sized European firms were not yet big enough
to benefit fully from scale economies (Defraigne, 2004).

These structural changes were clearly perceived by both business leaders and policy makers
(the former trying to influence the latter). Demand-side keynesian policies were more and
more criticized and structural, supply-side policies became more popular among the economic and political elites (Halimi, 2006). As far as the EEC is concerned, the existence of non-tariff barriers impeding free trade, as well as the unachieved Common Market (in the early seventies, the EEC was more a custom union than a common market), were considered as problems to be overcome. Business leaders lobbied in order to push forward the European integration (even through transfer of formerly national prerogatives – the European level being increasingly considered as the best level to act in a more and more open world). Lobbying groups of big European MNEs were set up as the European Roundtable of Industrialists (ERT, established in 1983). The ERT will play a significant role in pushing both the EEC and national states to go forward with the establishment of a true European common market, the Single European Market, with the ratification of the Single Act in 1986 (Gillingham, 2003). The hope was that by integrating more deeply the European markets (including labour and capital markets – in order to establish a true Common Market), growth will be promoted as well as employment (Cecchini Report, 1985). The 1980s will be characterized by a deepening of the European integration process, and the abolition of non-tariff trade barriers (see the arrest Cassis de Dijon, 1979, as well as the increasing role of the European Court of Justice). In the early 1990s capital markets became increasingly integrated. This posed new challenges (there is a dimension of incremental change in the European construction, each step necessitating the following one. See Bela-Balassa on the various stages of economic integration, from the free trade area to the full monetary and economic union, passing by the custom union, the common market, the economic policies convergence – and the fact that only the 2 extreme options are stable ones) (Bela Balassa). Since 1987, European states member of the EMS have tried to achieve a semi-fixed exchange rates (from 1987 to 1992). But the world changed in 1989 with the fall of the Berlin wall and the process of German reunification (the former GDR being de facto included as a new member in the European Community in October 1990). The German federal authorities increased their public expenditures to ensure the convergence of the East German economy, leading to higher German interest rates. In his theory of the impossible trilogy, Mundell has shown that autonomous monetary policies, fixed exchange rates and free flow of capital are mutually exclusive (El Agraa, 2007). One of the three elements has to be abandoned. European countries stuck to their fixed parities with the Mark, but this was not sustainable. France for example had to adopt a restrictive monetary policy at the worst moment (economic recession in the Anglo-American zone, to be followed next year by continental Europe). The speculative operators on the capital markets were well aware of this contradiction and played with it (Narassiguin, 1993). Two speculative episodes in August 1992 and September 1993 will provoke the end of the E.M.S. (actually, an enlargement of the fluctuation zone allowed for exchange rates at +/-15%). The only logical option if European countries wanted to preserve the benefits of an integrated common market was to step towards the common currency which was in Maastricht in 1992.

2.3. The second stage of the European integration process: the regionalisation of the production process of European MNE and the rise of economic disparity across the economies involved in the regional integration process.

2.3.1. The rise of efficiency-seeking investment after the opening of emerging economies

A second underlying microeconomic force affecting the European integration process began to emerge with the slowdown of the western economies in the 1970s and the restructuring of the world economy in the 1980s.

Most industrializing countries of the third world had been developing import-substitution industrialization strategies since the 1930s and 1940s. The combination of the world crisis of
the 1930s, WWII and the model of central planning developed in the USSR changed the perception of many policy-makers across third world countries. The role of the state in the economy was considerably extended with stronger industrial and protectionist policies and control on international capital flows. These two decades witnessed the foundation of the import-substitution industrialisation in Latin America (Bulmer Thomas, 2003). The military expansion of Soviet influence in Eastern Europe during WWII and the anti-imperialist revolutions in East Asia (China, Korea, Vietnam) led to the establishment of highly protected state-led economies in Eastern Europe and East Asia. Even many anticommunist governments in East Asia (South Korea, Taiwan, Thailand, Malaysia, Indonesia) opted for import-substitution industrialisation schemes and strong state control on the economy. They pursued an active industrial policy with subsidies, protection and negative list against foreign investors in key industries.

During this period of import-substitution industrialization from the 1930s to the 1980s, some multinational enterprises (MNEs) were expropriated, even in the non-communist economies such as Mexico (under Cardenas), Chili (under Frei and Allende) or South Korea (under Park). In most developing economies, FDI inward flows were canalized through various schemes to generate more spillovers on the domestic economy and to protect and nurture the infant industry. These restrictions on FDI -called New Forms of Investment (NFI)- included negative lists in strategic industries (telecoms, mining, energy, media, banking); maximum threshold of foreign ownership; compulsory joint-venture with a local company; compulsory export target; control on profit repatriation (Oman, 1994).

The MNEs that remained in these developing economies were mostly resource-seeking investments (raw materials) and market-seeking investments. Market-seeking investments were limited due to the size of the domestic market of a developing economy. Furthermore, various factors hindered foreign investors. Firstly, the various NFI imposed by the local governments constrained foreign investors. Some of the MNEs could go round some NFI but it implied additional costs. Secondly, there was a lack of certainty over property rights. IP protection was almost non-existent and expropriations were numerous. Finally, the unstable political climate in many developing countries raging with anti-capitalists and anti-imperialist movements that could result in total expropriation without compensation (such as Cuba, China or Vietnam) scared some investors, especially in some East Asian economies. Even in countries that did not face a direct revolutionary threat, local governments, under pressure by their population, used an anti-imperialist rhetoric hostile to MNEs (such Echeverria in Mexico, the FLN in Algeria, Peron in Argentina).

For these reasons, the progress of FDI flows to the developing world was relatively slow during this period. Sheltered by high tariffs and technical barriers to trade, the local subsidiaries of MNEs benefited from an oligopoly that enabled them to sell obsolete products with a substantial mark-up on the domestic market (e.g. old VW beetle models in Mexico). The local subsidiaries of MNEs located in developing economies often used a relatively cheap obsolete technology that has paid itself in the developed economies in the previous decade. They were dependent upon imported component from the subsidiaries of the MNEs located in the developed economies. They adapted to the import-substitution strategies of the developing countries but produced obsolete products that generally could not be re-exported to the developed economies. As their local production relied on the import high-tech components from their mother firm located in the developed countries, they contributed to the deterioration of the current account balance of these developing countries.

In the centrally-planned state-led economies of Eastern Europe and East Asia, foreign investors were quickly expropriated after WWII (mostly investors from Nazi Germany in Eastern Europe and mostly investors from Japan and colonial powers in the East Asian communist countries). These economies pursued import-substitution without the direct presence of foreign investors. Nevertheless, many of these governments in Eastern Europe
acquired turnkey-factories from Western MNEs in the automotive or household appliance industries: RCA in Poland; Fiat and Peugeot in different Eastern European economies (Berend, 1994 & Kolko, 1987).

Overall, the situation prevailing in terms of FDI from the 1930s to the 1980s was characterized by national state control on capital flows, severe restrictions on FDI and relatively high trade barriers on manufactured import in many emerging economies of the third world. In this context, resource-seeking and market seeking investments were the dominant form of FDI in the semi-periphery and the periphery of the world economy. During this period, efficiency-seeking investments that aim at reducing the cost of the MNE by internationalizing its production process in order to benefit from the various comparative advantages of the various economies were still marginal. In the 1960s and 1970s, thanks the progress of telecommunication and transport, some MNEs began to outsource some of their labour intensive activities to neighbouring developing countries, either directly or through subcontracting with a local firm. Outsourcing in the textile industry took place between West German firms and Eastern European local partners and between US firms and the Mexican maquiladoras. More significant were the efficiency-seeking investments made by US, Japanese and European electronics firms (notably Texas Instrument, Motorola, General Electric, Philips or Matsushita) in Eastern Asia (Singapore, Hong-Kong, Taiwan, South Korea) (Hobday, 1995 & Yamamura, 1997). These economies benefited from very specific conditions. Singapore and Hong-Kong were city-states that adopted a strategy of great openness, tight labour control and other incentives to attract foreign investors. These economies were also a privileged location for foreign investors due to specific geopolitical factors. Hong-Kong was under direct British rule, Taiwan and South Korea were key advanced posts for the US army in the strategy of containment. This situation provided these countries with a better infrastructure and a privileged access to the US market (the UK in case of Honk-Kong), two factors that fostered efficiency-seeking investment. However, the East Asian tigers were the exception rather than the rule. Efficiency-seeking FDI flows between the developed economies and the developing world remained negligible until the late 1980s because of the import substitution industrialisation strategies pursued by most emerging economies in the semi-periphery or due to remoteness, very poor infrastructure, lack of qualified labour force and political instability in the least developed countries of the periphery.

The global economy was profoundly transformed in the 1980s. With the emergence of the Eurocurrencies markets and the collapse of the Bretton Woods system, capital controls were progressively relaxed in the developed economies. As for the third world, many of the emerging economies were seriously hit by the rise of real interest rates on the global financial markets after the adoption of restrictive monetary policies by the US Federal Reserve Board in 1979, followed by its European partners. This sudden change between 1979 and 1981 revealed the fragility of the import substitution model. Imports of technology were becoming more expensive as the emerging country attempted to develop new and more capital-intensive industries. In parallel, the obsolete imported technology and the oligopolistic structure of the highly protected domestic market often did not produce competitive products that could be re-exported to developed economies. The current account deficit was easily financed in the 1970s through international borrowing. Negative real interest rates generated by the excess liquidity from the Eurocurrencies market and from the petrodollars made access to international loans relatively easy. Import substitution strategy became much more difficult to sustain once real interest rates rose sharply and some country defaulted. The fear of the banks from the industrialised countries, some of them saved only thanks government intervention, stopped the flows of private bank loans.

The International Financial Institutions (IMF, World Bank, Club of Paris) came in as last resort lenders and offered conditional loans submitted to the implementation of structural adjustment programs. These programs included a shift from import substitution
industrialisation strategy to an opening strategy favouring the relaxation of rules on inward FDI and the lowering of trade barriers. The East Asian tigers which hosted efficiency-seeking FDI to generate technological spill-over and improved their trade balance were presented as the model to follow, regardless of their specificities. NFI were relaxed and local governments from this developing countries developed specific fiscal and trade policies (e.g. export processing zones) to attract FDI. Most emerging economies that had not joined the GATT (WTO after 1995), applied and adopted the Uruguay round package including trade-related intellectual property aspects and the trade related investment measures. At the same time, inefficient state-owned companies were privatized as a mean to scale down public expenditures to pay back the debt. Many of these developing economies adopted debt-equity swaps.

This drastic change modified completely the environment that MNEs faced in developing countries. It enabled MNEs to make efficiency-seeking investments in the semi-periphery generating a massive increase of vertical intra-industrial trade (IIT). MNEs also took over the recently privatised state-owned companies in utilities, energy, transport, media and banking.

2.3.2. The adoption of a product differentiation strategy, the regionalisation of the production process and their consequence on regional integration

During the 1980s and 1990s, MNEs began to take advantages of these new opportunities offered by developing countries and began to regionalize their production process by scattering geographically the different stages of its production and distribution processes according to the specific comparative advantages of each country in a given region. Although some MNEs did globalize their production process across different regions of the globe, most MNEs opted to reorganize their production process at the regional rather than the global level. Various factors influenced MNEs in their choice, notably the necessity to react quickly to changes in consumer preferences.

In the 1980s, MNEs from the most advanced economies decided to defend themselves against competions from emerging economies (mostly the East Asian tigers) by adopting a strategy of product differentiation. Upgrading and multiplying the models were a mean to erect barriers to entry against firms from the emerging economies which could copy simple large-scale standardization product but which had not the technological know-how and the financial resources to compete against the proliferation of differentiated models. The multiplication of differentiated models and the intensification of international competition increased the volatility of the consumer demands. For this reason, it became much more essential for the firm to benefit from a quick feed-back on the new models that it launches on the markets and to be able to adapt quickly by shifting to lean production methods with just-in-time, more flexible lines of production and have production units that were not too geographically distant from the final consumer.

At the same time, the differentiation of product also meant that firms had to target the regional market rather than the national market. The differentiation of produced induced higher fixed cost in R&D (to upgrade the product technologically and to design more new models); in robotics and computers (to adopt flexible multi-models production lines) and in marketing (new marketing campaigns had to be organized to popularise more new models implying more budget for advertising). This considerable rise in fixed cost increased the minimum efficient scale of the firm in industries that were either R&D intensive (chemistry, optics, transport vehicles except cars), advertising intensive (food and drinks, tobacco) or both (car industry, cosmetics, computers). Apart from very large economies like the US and Japan, national markets were too narrow for the firm to be able to operate at the new minimum efficient scale.
For these reasons, many MNEs that had opted for a product differentiation strategy and that had regionalized their production process in the 1980s and 1990s began to play a more active role in promoting regional integration schemes. MNEs that had regionalized their production process were now pressing their state authorities for an acceleration of regional integration that could facilitate vertical intra-industrial trade and FDI across a region with a large degree of heterogeneity in terms of resource endowments.

This process first took place in East Asia with Japanese MNEs at first, then with Korean and Taiwanese MNEs. Japanese MNEs were helped through the “regional guidance” of the MITI and JETRO to facilitate the RPP of Japanese MNEs. Japanese firms faced mounting trade friction with the Western economies and their competitiveness was seriously hampered by the appreciation of the yen, especially after the Plaza accord in 1985 (the *endaka*) (Terry, 2004 & Plagnol, 1995). Japanese firms began to relocate some of their labour-intensive activities to the ASEAN and coastal China (Terry, 2004; Yamamura, 1997). Korean and Taiwanese firms that faced rising labour costs and tighter labour laws in the late 1980s also began to relocate to neighbouring less advanced economies (Lee, Hobday, 1995). Most MNEs from Japan and the East Asian tigers deepened their RPP during the 1990s and were soon followed by their first-tier subcontractors. The process was completed in the first years of the new millennium with the last companies like Canon which had been reluctant to regionalize their production process but which finally relocated labour-intensive activities to China (FT, 2003). Japanese companies had developed a complex web of subsidiaries and subcontractors across the region that fostered vertical IIT flows (Hatch, 2000). As a consequence, the Japanese elites began to develop a hub-and-spoke regional integration strategy by negotiating WTO+ preferential trade agreements (including some of the so-called Singapore Issues on investment, procurements, competition rules and trade facilitation) with their most important ASEAN partners and with South Korea.

In North America, a similar process took place with US MNEs making efficiency-seeking FDI in Mexico. This generated a dramatic increase of vertical IIT flows which completely transformed the structure of Mexican trade (exporting now mainly manufactured products to the US market) (Lustig, 1994; Tennier, 2003 & Santander, 2008). Although less important, substantial US efficiency-seeking FDI were also made in Central America (Dicken, 2008). The RPP of US firms was facilitated through the establishment of the NAFTA in 1994 and of the CAFTA+D in 2005.

This new underlying microeconomic dynamic also pushed the Western European political elites to accelerate preferential trade arrangements with their neighbours of the semi-periphery. The enlargements of 2004 and 2007 made the Eastern European countries adopt the *acquis communautaire*, thereby creating a familiar and secure legal and administrative environment for Western European MNEs, facilitating their RPP. Other countries at the semi-periphery also benefited from the WTO+ agreements, notably Turkey with the creation of an effective custom union for most manufactured products in 1996.

This new underlying microeconomic force generated by the RPP of MNEs strongly affected the nature of these regional integration processes in East Asia, the Americas or Europe. MNEs were interested in promoting regional integration processes that included neighbouring countries from the semi-periphery (e.g. Czech Republic, Mexico, Thailand) or even the periphery (e.g. Honduras, Philippines, Rumania). Increasing the heterogeneity of the economic development level by enlarging the integrated region towards the semi-periphery was essential to the MNEs as their RPP seeks to benefit from the regional differences in resource-endowments and institutional environments. Labour and land were cheaper in the developing economies of the semi-periphery or the periphery. These developing countries had given up the ISI strategy in the 1980s and were hoping to attract as much FDI flows to foster their economic development. To achieve this objective, they often offered very loose labour regulations and a very lenient fiscal system for MNEs (Oman, 1994; Chesnais, 2004; OECD,
MNEs have an interest in maintaining these regional disparities, even if this means to extend geographically their RPP further to include even less developed economies as the cost of the labour force and land increase in the semi-peripherical economies of the regions due to the economic development generated by the wave of efficiency-seeking FDI. This pattern is clearly visible in the three regional integration processes in East Asia, the Americas and Europe.

In East Asia, Japanese MNEs have been extending towards the new ASEAN members like Vietnam. In order to maintain these regional disparities and to increase their bargaining power, they have adopted a two pronged strategy, setting up alternative production processes in the ASEAN and in China (Yamamura, 1997). Japanese MNEs can also develop new production in the less developed Chinese provinces to benefit from the large pool of cheap labour force and benefit from Japanese ODA programs to improve the infrastructure in inland China (Terry, 2004 & Doner, 1993). In the Americas, NAFTA has been used as model to set up the CAFTA+D agreement (Santander, 2008). In parallel, transport infrastructure is being developed in order to create a network of highways from Central American states to the US. These developments are helping the US MNEs to extend their RPP to Central America. In Europe, the same process is at work with the successive enlargements in 2004 and 2007. For example, VW and some of its first and second tiers suppliers have completed a complex RPP by relocating many of their low-value labour-intensive activities to neighbouring new members states (Dicken, 2007). The global competitors of the telecom industry in Finland and Sweden have used the Baltic for their efficiency-seeking investments (Chalvin, 2006).

These factors explain the selective approach of business regarding institutional harmonization within the European Union. In the 1980s, the European Roundtable of Industrialists had strongly supported technical harmonization and the launching of the Single European Market to lower non tariff barriers within the Common Market in order to enable the largest European firms to benefit from more economies of scale. In the late 1990s and 2000s, Eurobusiness is not interested in developing fiscal or social security harmonization between the old and new member states and focus on the enforcement of the *acquis communautaire* in order to ensure the proper functioning of the single market.

### 3.3. The common pattern of the integration processes driven by the RPP of MNEs in East Asia, America and Europe

The common pattern of these three integration processes is to be mainly driven by the RPP of the MNEs originating from the most advanced economies since the 1990s.

This has generated *de facto* regional integration processes that include very heterogeneous countries in terms of economic development. In this regional division of labour, the most advanced countries (Northwest Europe, the US, Japan) are hosting high-tech Marshallian districts or a pool of highly qualified labour force while the less advanced can offer a pool of cheap labour force with looser labour regulations and lenient fiscal systems for MNEs.

The MNEs engaged in the regional distribution of their production process have no peculiar interests in supporting regional cohesion policies or fiscal or social harmonization. The latter could possibly raise their costs and force them to find new places for their low-skill production. Moreover, a harmonization towards West-European standards can mean increased transfers and therefore increased taxes in the home countries of these multinational enterprises. On the other side, harmonizing towards the mean of the overall regional zones can mean a severe reduction of the advantages in the better-off zones (Western Europe for example) that are difficult to justify from a mere political point of view (even if economic forces in a common market can lead to the same result).
The MNEs do not have many incentives to support solid supranational institutions imposing from above a harmonization process of social, fiscal and environmental norms. It is more interesting for them to just support regional agreements favouring free trade, free movement of capital and of qualified manpower, that can reduce national sovereignty (when the latter is an obstacle to their strategies).

The home countries of the main MNEs of their respective zone of integration (USA for NAFTA, or AFTA; Japan for ASEAN+3) have no incentive to reduce their own national sovereignty to transfer parts of their national competencies to supranational entities, as they already enjoy a dominant economic position in their zone. It has to be noted that this asymmetry is not assumed to be fixed by all partners in respectively the American Free Trade Area or in East-Asia : Brazil and China do contest the economic supremacy of the US or Japan (but the latter multiply the bilateral free trade agreements to diminish the weight of those emerging powers). Even if China possesses more non-economic assets to challenge the dominant position of Japan than Brazil over the USA, both nevertheless remain technologically dependent from foreign countries and cannot allow themselves to remain outside free trade areas or economic and trade agreements with the dominant power of their zone. There is not the same balance of power in East-Asia or America that exists in Europe, so the need for Japan or USA to create a permanent international forum of discussion (through the setting up of multinational institutions) between them and the various countries of their zone of influence is not so important as it was and it is in Europe. We therefore cannot anticipate the same level of political regional integration in these zones as it is less necessary.

4. The likely future of the European model in the light of the comparison with the other regional integration processes

The comparative analysis of the regional integration processes in North-America and Asia has helped us to ascertain our understanding of the specific and unique characteristics of the European integration process. The first main feature is the economic rationale behind the first phase of the integration process in Europe (from 1950 to 1985). In Europe, it was the need to build a truly integrated common market to allow European firms to benefit from scale economies comparable to the one enjoyed by their US rivals. This idea that « (market) size matters » (Alesina and Spolaore, 2003) and the search for scale economies through economic integration did not impose the need to integrate heterogeneous countries. Homogeneity was not an obstacle and was itself an advocated goal of the first phase of European integration. A second feature was that within the European zone, the biggest and most powerful country (Germany) was never so dominant as to ignore the necessity to deal permanently with the other powers (mainly France). The relative symmetry between the partners of the first phase of economic integration (EU-6) implied the need to set up a permanent bargaining forum and to reach compromise. This led to the building of the European supranational institutions. This process was relatively easy to realize during the 50s, the more so that it was also supported from the outside by the USA (for geopolitical reason, as part of a strategy of containment of the Soviet influence). The USA has played a key role in the process, especially at the beginning of the process. The established supranational framework (Treaty of Rome, EEC…) also allowed the pursuit of truly supranational policies (the Common Agricultural Policy since 1963, the European Monetary System, the structural policies..). This gave a unique character to the European integration process, much more political than the one launched three decades later in North America or in Asia.

However another economic process imposed its logic during the late 80s: the regionalisation of the production process of European (or operating in Europe) MNEs, pushed by an increased internationalisation (openness, and therefore competitive pressure) of the economy as well as by changes of consumer behaviour in more affluent society. Flexibility, R&D, marketing and advertising became more central and implied increased fixed costs. The search
for cost reduction especially for low tech parts of the production process led to an increased lobbying to reduce trade barriers, and extend the reach of free trade and common market to a set of more heterogeneous countries. As in North-America (where the US firms de-located low tech activities in Mexico, e.g.), the very same economic logic made attractive the integration of less developed, poorer countries (the Mediterranean European countries and after 1989 the Central-Eastern European economies) in the European Economic Community, as well as making attractive trade agreement and privileged partnerships with (poorer) countries from the European near-periphery (Tunisia, Turkey). Such a heterogeneous framework helped the European firms to trade off various advantages (factorial endowments, differences in environmental, social and fiscal regulations). During this second stage of the European integration process (from 1985-90 up to now), the heterogeneity of the European Union has considerably increased (see table 1 in appendix). The reduction of this heterogeneity is no more functional in the new microeconomic logic. As their US or Japanese rivals, European MNEs have no real interest in the reduction of the degree of heterogeneity from which they benefit in terms of cost reduction. Heterogeneity within the EU give them much room of decision and the governments of the central European powers (France, UK, Germany) as well as the EU officials do not want to reduce elements that give MNEs competitive advantage. We have assumed from their part a kind of neo-mercantilist (Listian) agenda: the objective that policy-makers are allowed to pursue is the economic well-being (proxied by growth and competitiveness) of the EU area. As they see MNEs as key actors in promoting EU growth and competitiveness, they do not want to reduce the room of action left to them – and therefore do not want to pursue harmonization policies (both possibly costly and growth-impeding).

If the wealthiest countries do not want to increase their tax burden to finance an harmonization that they can envisage as an impediment to their MNEs competitiveness, the new emerging EU economies (as Ireland, the Baltic countries or East-European members) do not favour those policies either. They indeed consider that they benefit from the heterogeneity and opposed any harmonization towards the social, fiscal or environmental norms of Western Europe in order to preserve their attractiveness for FDI. The latter are viewed as key tools to manage the transition towards full-fledged developed capitalist economies. The governments and experts of the 10 new member-states do not oppose the regional division of labour implicitly set up by the economic forces (but also by policies friendly to MNEs objectives). They consider as parts of their comparative advantage their low costs of labour, low tax rates and lax social and environmental regulations (at least at this stage of their economic development).

It should astonish nobody to see that the social dimension of the European integration process remains under-developed (to say the least), as well as the fiscal integration. And if social harmonization occurred, it is mainly (as the directive “temps de travail”) towards the least constraining rules for employers. As far as fiscal integration is concerned, the objectives at the EU level remain very modest. As an illustration, one can look at article 171 of Chapter III of the Project of European Constitution. It stated that an European law or outline law by the Council establish the measures concerning the harmonisation of legislation concerning the value-added taxes and other indirect taxes, as long as this legislation is needed either to ensure the setting up or the working of the internal market and avoid competition distortions. It also state that the Council decides at unanimity after consultation of the EU Parliament and Social and Economic Committee”. In the today context of the EU, requiring the unanimity is synonymous to blocking any advance in terms of fiscal harmonisation.

Moreover (and following the same philosophy of the today Asian and American integration processes), cohesion and regional policies are under severe attack (at least in the forms adopted during the first phase of the European integration process). The famous Sapir report (2003), written to specify the main strategic orientations for the EU in the next decennium, suggested that the share of European GDP devoted to the budget for EU policies and the
working of the EU supranational institutions did not increase even after the inclusion of the 10 new member-states, no matter the fact that their economies lagged considerably behind the EU average (Devoluy, 2004).

The EU cohesion structural policies are becoming less ambitious. According to Boillot (2003), the share of support that the new members will receive in terms of their GDP will be 3% lower than the same share received by Spain and Portugal during the 80s, even if the latter suffered from much less severe economic problems.

As far as the CAP is concerned, the East-European producers will receive less than their Western competitors even if they are much less mechanised and less competitive. The subventions to Eastern producers will begin at 25% of the level received by the current members and these subventions will slowly rise to reach the same level only in 2013. This lack of support for the East-European agriculture, often less mechanised and characterised (as in Poland) by too small farms, will lead to a much more severe adjustment that the one faced by Western European farmers during the 60s at the onset of the CAP. The loss of jobs in agricultural sectors has been estimated to four million people 5. This will induce downward pressure on the wage level of low-skilled workers, maintaining by the way the relative level of wages in such a way that the regionalisation of the production process of MNEs will continue. After the adjustment, the agricultural sector will be characterised by large and competitive producers.

Therefore, the second stage of the European integration process, partly driven by the interest of the big MNEs to regionalise their production process, is characterised by a large degree of regional heterogeneity and much less ambition to build at the European level the kind of super-state dreamt by some federalists. In this sense, being less political, more economic and allowing much more divergence between members, the EU integration process tends to converge with the one observed in East-Asia and America (at least in terms of general trends). Of course, the EU supranational institutional framework remains more or less the same and of course multinational institutions still regulate the working of the integrated European market. The specific history (institutional path-dependence) of the EU integration process ensured that its main characteristics remain different from the American or Asian ones. But this is mainly something of the past, as we have shown that the new microeconomic logic of MNEs render the political integration process and the reduction of disparities much less desirable. The supranational European institutions tend to regulate the European market in order to facilitate a process viewed as favourable for the European MNEs and the EU competitiveness as a whole (in a neo-mercantilist perspective), not to counteract if. The nature of this process can only increase the heterogeneity and asymmetry between the various regions of the new enlarged Europe. The policies aimed at reducing those disparities are much less in favour. In a sense, in regional terms as well, “inequalities” (or heterogeneity) is more viewed as an asset than a hindrance to economic performance. The European project tends therefore more towards a vast free trade union (with some policies favouring also the free flow of capital, investment-friendly policies and measures favouring the mobility of workers, especially high-skilled ones).

It is not sure that such a project, much more economic than the political and “idealistic” one of the first stage (even if this one as well responded to clear economic rationale and the interest of the big enterprises of the time), much less adverse to widening inequalities, will raise much support from the European populations. The creation of a common market between very asymmetric economies create an important pressure against the “welfare-state” models built after the WW2 and considered by many West-European supporters of the European unification as a key characteristics of the “European model”. The convergence of the EU integration process towards the one observed elsewhere will be accompanied by the erosion

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5 Alternatives économiques, May 2004.
of the social and economic advantages enjoyed by the European workers during the first stage of European integration process. The convergence of the European model of capitalism towards a more rude (Anglo-Saxon) model bring severe risks of discontentment among the West European populations (see the rise of Die Linke in Germany or the various “no” in the referendums for the European Constitution or the Lisbonne Treaty). For the East-European populations, the structural adjustment of their agriculture, the low level of subsidies received from the EU and the huge inequalities tend also to lead to some kind of disillusionment (illustrated by various extremist political movements and the extremely low turn-out in most elections).

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