OECD DEVELOPMENT CENTRE

POLICY BRIEF No. 11

THE POLICY CHALLENGES OF GLOBALISATION AND REGIONALISATION

by

Charles Oman

- Globalisation and regionalisation tend to be mutually reinforcing. Policies must ensure that this outcome prevails, for non-OECD and OECD countries alike.
- Globalisation can weaken social cohesion and States' economic policy autonomy.
- Post-taylorist "flexible" forms of organisation now drive and shape globalisation.
- The crisis of taylorist organisations is an important cause of the "structural" labour-market problems that now plague the United States and Europe; imports from developing countries are not.
- Globalisation today does not show any significant acceleration of industrial redeployment from OECD countries.

POLICY BRIEF No. 11

THE POLICY CHALLENGES OF GLOBALISATION AND REGIONALISATION

by

Charles Oman

THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS PUBLICATION ARE THE SOLE RESPONSIBILITY OF THE AUTHORS AND DO NOT NECESSARILY REFLECT THOSE OF THE OECD OR OF THE GOVERNMENTS OF ITS MEMBER COUNTRIES.

© OECD 1996

Contents

Executive Summary 5
1. The Concepts, the Focus 6
2. Globalisation Today 8
3. Flexible Production and the Crisis of Taylorism 19
4. Regionalisation 29
5. Conclusions 35
Notes and References 43

Executive Summary

Deeply interconnected, globalisation and regionalisation should mutually reinforce one another. Policy must ensure that this outcome prevails.

The current wave of globalisation — the third in this century — now transforming OECD and non-OECD countries alike has several specific but interrelated features that help distinguish it from past episodes: deregulation in the large economies; new technologies and the innovation that accompanies their spread; financial globalisation; sweeping policy changes in non-OECD countries (privatisation, liberalisation, deregulation); and the altered dynamics of inter-firm competition in the leading economies. All either originate from or affect policy, and they go some distance to explain why globalisation today differs from that in the past. Yet they do not go far enough. The crucial difference is that globalisation is a microeconomic phenomenon, driven and shaped by the spread and development of post-taylorist "flexible" forms of economic organisation. As such, it calls for a range of policy responses in OECD and non-OECD countries alike — policies which will capture the large potential benefits from the productivity-enhancing features and long-term growth dynamics of globalisation, and do so in ways that strengthen societies and their institutions.

Regionalisation, especially in its *de jure* forms involving greater or lesser degrees of formal policy integration among governments, emerges as a political response to the challenges of globalisation and at the same time helps to strengthen the microeconomic forces that drive globalisation by stimulating internal competition; significantly enlarging regional markets open to participants; weakening the power of special-interest groups which resist greater competition or attempt to turn regional agreements into bastions of protection; and re-establishing collectively, among participants, policy sovereignty vis-à-vis internal and global markets. It can be a valuable instrument for "deep" international policy integration, which globalisation increasingly requires. As a political phenomenon, however, regionalisation runs the risk, under perverse policies, of becoming a tool for regional protection, whereby it loses its value as a policy tool for strengthening regional growth and competitiveness in global markets.

The OECD countries need policies to facilitate and encourage the transition to flexible production and the development of flexible organisations, rather than succumb to pressures to resist change through protection or other measures to restrict competition. Non-OECD countries face a double challenge: first, to open up to the global economy and, second, to deal with the implications of globalisation

in the OECD countries. This *Policy Brief* explores these policy requirements in detail, in the context of a thorough analysis of globalisation and regionalisation and their economic and political implications.

1. The Concepts, the Focus

"Globalisation" and "regionalisation" are terms used by many but defined by few. Before looking at their policy implications, and at how the two phenomena interact, the concepts need definition.

"Globalisation" is the growth, or more precisely the accelerated growth, of economic activity across national and regional political boundaries. It finds expression in the increased movement of tangible and intangible goods and services, including ownership rights, via trade and investment, and often of people, via migration. It can be and often is facilitated by a lowering of government impediments to that movement, and/or by technological progress, notably in transportation and communications. The actions of individual economic actors, firms, banks, people, drive it, usually in the pursuit of profit, often spurred by the pressures of competition. Globalisation is thus a *centrifugal* process, a process of economic outreach, and a microeconomic phenomenon.

Defined in these generic terms, globalisation is not new. The last 100 years alone have witnessed three distinct periods or "waves" of globalisation: we have been in the midst of one since the 1980s; another occurred during the 1950s and 1960s; while the previous wave took place during the 50 years or so prior to World War I[1]. Globalisation resembles and builds on earlier periods of globalisation; but globalisation today also differs crucially from earlier periods. Policies to deal with globalisation must come to grips with the specificity of the process today, especially at the microeconomic level, relative to globalisation in the 1950s and 1960s, in particular.

"Regionalisation" is in turn a *centripetal* process that involves the movement of two or more economies, i.e. two or more *societies*, towards greater integration with one another. It can be a *de jure* phenomenon, driven by political forces that are motivated by security, economic or other concerns; or it can be a *de facto* outcome, driven by the same microeconomic forces that drive globalisation.

As a political phenomenon, *de jure* regionalisation takes a variety of institutional forms. These range from a "free" or preferential trade agreement, in which participants do not have a common external trade policy, or a customs union, in which they do, to deeper forms of integration, such as the tying of

currencies, the harmonisation of some domestic policies, and mutual recognition of standards and regulations; in the extreme it can involve full economic, monetary and political union[2]. These institutional arrangements have in common the exercise of the extra-economic powers of state to lower barriers, especially policy barriers, to intraregional economic activity. To a greater or lesser degree, governments also pool their powers of state, hence their policy sovereignty, usually with the aim of collectively strengthening that sovereignty vis-à-vis the rest of the world, economically and/or politically, as well as to enhance the region's economic growth and strength.

Regionalisation does not always take the form of *de jure* arrangements among governments, i.e. it is not always a political phenomenon. It can be "natural" or *de facto*, as in Pacific Asia today, or between the United States and both Canada and Mexico before NAFTA. Significant cross-border trade, investment and perhaps migratory flows due to geographical and/or cultural proximity can lead to growing regional integration without *de jure* arrangements. We return to regionalisation, and the question of how it relates today to globalisation, in Section 4 of this *Policy Brief*.

The next section, Section 2, focuses on several factors that have contributed significantly, separately and in combination, to shaping the current wave of globalisation, and to shaping widespread *perceptions* of globalisation, with which policy makers must also deal, since the late 1970s. Among the most important are policy shifts in both OECD and non-OECD countries, the advent and spread of the new "information" technologies, and the globalisation of financial markets.

Section 3 examines the critical, and, at least among economists, much more poorly understood, microeconomic dimension of globalisation today. It focuses on the crisis of Taylorism and "scientific management" as the dominant paradigm for organising economic activity in the leading economies, and on the emergence of post-taylorist "flexible" or "lean" organisations whose formidable competitive strength constitutes the principal microeconomic force now driving globalisation. This distinction between the crisis of Taylorism, on the one hand, and the strength of flexible organisations in driving and shaping the current wave of globalisation, on the other, is particularly important because the former, much more than the latter, is a major cause of the severe "structural" labour-market problems both in Europe (where the problem mainly takes the form of high unemployment) and in the United States (where it mainly takes the form of stagnant wages, rising inequality and growing numbers of "working poor"). Many people mistakenly blame "globalisation" for those labour-market problems, when in fact the crisis

of Taylorism and the difficulties of moving from taylorist to post-taylorist forms of organisation in the leading economies (where taylorist organisations, and taylorist ways of thinking, are most deeply entrenched) are more to blame.

Section 4 then turns to regionalisation and the interaction between globalisation and regionalisation. It argues that today, as in the past, the two tend to be mutually reinforcing. A key challenge for policy makers, nevertheless, is to ensure that they are indeed mutually reinforcing, by making sure that regional integration agreements serve to strengthen internal competition, and are not used as means to protect regional markets. *De jure* regional arrangements can also be invaluable vehicles for "deep" policy harmonisation or integration among governments, which globalisation increasingly requires.

Section 5 concludes the *Policy Brief* with a summary and further policy implications for OECD countries, for non-OECD countries, and for relations between the two groups. It argues that the main challenge, for firms as well as for governments, is to devise policies that reap maximum benefit from the productivity-enhancing features of globalisation in ways that strengthen, rather than weaken, social cohesion.

2. Globalisation Today

As a centrifugal process and as a microeconomic phenomenon, driven by the actions of individual economic actors, globalisation reduces the economic "distance" not only between countries and regions, but between the economic actors themselves. It also tends to disrupt entrenched oligopolies, effectively changing the "rules of the game" in the struggle for competitive advantage among firms, within countries as well as between countries. Such disruption feeds perceptions of increased uncertainty and instability within countries, just as the reduced economic "distance" feeds perceptions of increased interdependence between countries, both of which tend to be associated with globalisation.

Government policies normally facilitate and often stimulate — or on the contrary inhibit or impede — the economic forces that drive globalisation; these policies include both international policies, such as the raising or lowering of impediments to trade or capital flows, and traditional domestic policies such as labour and environmental standards and policies on competition, innovation and intellectual property rights, for example. Developments in technology, notably in transportation and communications but also in product or production technologies, and major new developments in management and organisational techniques, i.e. in the way activity is organised within and between firms, direct and organise the

forces of globalisation. In any given country or region, underlying economic conditions, notably the strength of growth and the level of development, influence these forces as well. Political instability or conflict mainly inhibit them.

Today, the movement of tangible and especially intangible forms of capital, finance, technology, the ownership or control of assets, has become the most prominent feature of globalisation, while corporate strategies and behaviour (in both the financial and non-financial sectors) drive it. Rapid and pervasive technological change, notably in the application of microelectronics, and changes in government policies, notably market deregulation, have visibly shaped and given impulse to a new wave of globalisation since the late 1970s. Equally important is far-reaching change in "industrial organisation", i.e. the way activity is organised within firms and the way firms co-operate and compete. This change blurs the very distinction between industry and services. More than any other, it disrupts entrenched oligopolies and alters the "rules of the game" across many sectors, worldwide.

Globalisation Before World War I

Strong trade growth and even stronger growth of inter-continental financial and migratory flows characterised globalisation during the 50 years or so that preceded World War I . That growth was particularly strong from 1870 to 1914, when much of the world was on the gold standard, or what amounted to a global currency, and Great Britain was the leading economy[3]. The period also saw a powerful new surge of European colonialism in Africa and Asia; major technological advances both in industry, i.e. in production and in products, and in transportation and communications; and the emergence of giant financial trusts and joint-stock corporations in Europe and the United States, and of the *zaibatsu* in Japan, along with the separation of ownership and management (i.e. the advent of corporate capitalism). All of these reinforced the oligopolistic nature of competition in the leading economies. The development of interchangeable parts and the emergence of mass production in the United States greatly increased productivity in US manufacturing.

Towards the end of the period, the United States also witnessed the emergence of Taylorism, i.e. the principles of "scientific" management that would come, in the course of the 20th century, to dominate management practices in the constitution and running of large organisations virtually worldwide, in industry and modern services and even in government. Developed by Frederick W. Taylor on the basis of time-and-motion studies, the principles of scientific management — well satirised in Charlie Chaplin's movie *Modern Times* — include (a) a

tendency to separate "thinking" and "doing", i.e. to separate conception from execution in the organisation of work, (b) a high degree of job specialisation, and (c) emphasis on the notion of "one best way" of doing things. These organisational features greatly increased the productivity of labour, compared to craft organisations, and, in manufacturing, created the potential for reaping economies of scale in the production of highly standardised products. They would also tend, over time, to build considerable rigidity into mass production — and, more generally, into the running of large organisations.

Globalisation in the 1950s and 1960s

Following World War I, the collapse of globalisation, the Great Depression, and World War II, the next wave of globalisation came during the "golden era" of postwar growth in the 1950s and 1960s, when the United States was the uncontested leader of the capitalist world and the dollar was the international currency under the Bretton Woods system of fixed-but-adjustable exchange rates. International trade, which had fallen to its lowest level in well over a century, grew strongly. That growth of trade, driven by the strength of economic growth, was facilitated by the substantial lowering of tariffs on manufactures in the developed countries under GATT auspices, and within Europe by the creation of the Common Market, as well as by improved transportation and communications technologies, many developed during and prior to the War.

Even more spectacular was the growth of multinational enterprise and foreign direct investment, led by US firms. That investment focused mainly on production or assembly to serve the market of the country *hosting* the investment in a context of oligopolistic competition within relatively segmented or circumscribed national markets or, in the case of Europe, regional markets. Industrial redeployment, on the other hand, i.e. the relocation of production capabilities from high- to low-wage countries to serve markets in the high-wage countries, remained insignificant until the late 1960s, when it began to accelerate; it became significant only after the mid-1970s[4].

During the 1950s and 1960s Taylorism finally spread widely outside the United States, and constituted the principal microeconomic force driving globalisation. In Europe, where craft traditions remained deeply rooted until after World War II, the development of scientific management and mass production constituted the microeconomic foundation for the development of mass consumption and for the advent of the "welfare state". In contrast, the spread of Taylorism to the "modern sector" in many developing countries — and its

development in many centrally planned economies as well — did not lead to a comparable development of productivity levels or of mass consumption in those countries[5].

The global spread and development of Taylorism in the 1950s and 1960s greatly enhanced productivity levels, worldwide. But it also laid the foundations for a building up, over time, of rigidities in production and in the running of large organisations. Those rigidities became an important cause of the slowing of productivity growth in the leading economies in the 1970s.[6] They were visible too in the relative stagnation from the late 1960s and especially during the 1970s of innovation, both technological and organisational, in many of the large taylorist firms whose growth drove globalisation in the 1950s and 1960s[7]. They also gave impetus to industrial redeployment by a growing number of OECD-based firms, especially US firms, in response to the squeeze on profits that accompanied the productivity slowdown at home during the 1970s, in what can be understood as an international extension of the internal logic of taylorist production by firms seeking to regain a measure of flexibility in production, as well as to cut labour costs and restore profit margins.

Those same rigidities, and the slowing of productivity growth, contributed importantly to the emergence of stagflation in the United States and Europe (where it was called Eurosclerosis) in the latter half of the 1970s. US and European policy responses to stagflation, from the late 1970s, in turn, became a major stimulus to the current wave of globalisation.

Globalisation in the 1980s and 1990s

Several phenomena have combined to stimulate, facilitate and shape the new wave of globalisation since the late 1970s — and to shape public *perceptions* of globalisation today as well. In addition to the US and European policy responses to stagflation — notably deregulation, and monetary "shock treatment" in the United States — those phenomena include the development and diffusion of new technologies; the globalisation of financial markets; the massive shift by developing countries from inward- to outward-oriented growth strategies; the emergence of widespread concern for the global environment; the end of bi-polarity; and the globalisation of corporate competition and co-operation.

Deregulation. Launched as a policy response to stagflation, the move to deregulate in OECD countries has focused largely on services, notably financial services, transportation, and communications (and, in the United States, on energy). The move began in the United States under the Carter administration in the late 1970s along with monetary shock treatment, which greatly increased

interest rates and led to a further squeeze on US corporate profits and to the recession of the early 1980s, and contributed to the emergence of the Third World debt crisis in 1982. Deregulation continued in the 1980s under Ronald Reagan, under Margaret Thatcher in the United Kingdom, and in the European Community in conjunction with preparations for the Single Market — a programme conceived in the early 1980s and launched in 1985 (to be completed by 1992). Indeed, the EC's Single Market programme can usefully be understood as continental Europe's deregulatory policy response to Eurosclerosis, Anglo-Saxon deregulation, and the perceived need to stimulate competition within Europe as a means to strengthen European competitiveness in the global economy.

Deregulation in the OECD countries has both facilitated and stimulated the current wave of globalisation in at least three ways. First, it has significantly increased competition and lowered prices, and hence the costs to users, as well as helped improve the quality of transportation (notably air), communications (notably telecommunications), and financial services. Second, financial deregulation has facilitated the development of new financial instruments (e.g. securitisation of debt, junk bonds) which have played a central role in financing the explosive growth of non-financial corporate mergers and acquisitions, especially in the latter half of the 1980s, both domestic and international[8]. Third, financial deregulation has been a major stimulus to the globalisation of financial markets (see below).

New technologies. From the late 1960s, innovation slowed visibly in the main clusters of technology underpinning the industries whose growth led globalisation in the 1950s and 1960s. Since the late 1970s, in contrast, it has accelerated. Remarkable new developments in technology — many taking place outside the large taylorist organisations — have had, and continue to have, profound economy-wide effects.

Advances in biotechnology and in materials technology hold considerable promise. But by far the most important have been the advent and rapid international diffusion of the new microelectronics-based information and communications technologies, including the application of the microprocessor to new products and production processes, which have left few manufacturing and service industries untouched. Included in the latter are the transportation and communications industries, and the media, where market deregulation and technological innovation have greatly expanded capabilities while spectacularly reducing user costs. This promoted the phenomenal growth of instantaneous worldwide information flows, as well as cheaper, faster and more reliable transportation of goods and people, opening wider global access to knowledge

about new products and services by potential buyers and about market opportunities by potential suppliers, thereby further stimulating the globalisation of markets and of competition.

Financial Globalisation. Remarkably global prior to World War I, international finance virtually collapsed during the inter-war period and began effectively to re-emerge only during the 1960s with the creation of the Eurodollar and other "offshore" financial markets. It gained considerable momentum after the collapse of the Bretton Woods system in 1971-1973 (speculative activity in the offshore markets was itself a major catalyst of that collapse), and its growth has been most spectacular since the late 1970s. The deregulation of financial markets and the advent of the new information technologies together have given major impetus to that growth. The value of cross-border assets held by banks more than tripled between 1983 and 1993, for example, and global foreign-exchange transactions, which tripled between 1986 and 1992 alone, now amount to more than $1.2 trillion ($1 200 billion) *per day*, on average, even after allowing for double counting due to local and cross-border inter-dealer transactions. Foreign-exchange transactions (of which exchange-rate arbitrage and speculation are estimated to account for about 80 per cent) thus amount to over 100 times the value of total worldwide trade in manufactures and services; they have grown from a daily average of less than $20 billion in 1973, about $60 billion in 1983, some $590 billion in 1989, and $820 billion in 1992. The stock of financial assets traded globally (as distinct from foreign-exchange transactions) is estimated to have grown from $5 trillion in 1980 to $35 trillion in 1992 (equivalent to twice the GDP of OECD countries) and is forecast to reach $83 trillion (three times the OECD economies' GDP) by the year 2000[9].

The globalisation of financial markets and financial deregulation together are a major cause of the perceived weakening of national economic policy autonomy — vis-à-vis other governments but especially vis-à-vis the global market. The sheer volume of highly liquid, mobile funds circulating in the global market significantly reduces central banks' ability to manage exchange rates. The *volatility* in exchange-rate fluctuations has in turn become far greater in the 1980s and 1990s than anyone anticipated after the demise of the Bretton Woods system and the introduction of market-determined exchange rates.

Financial globalisation and deregulation do not just weaken central banks' ability to manage exchange rates; they also weaken the effectiveness and autonomy of national monetary and fiscal policy — and the state's ability to govern markets — more broadly. They have made it more difficult to control interest rates — not least because domestic interest rates have increasingly been used to try to stabilise exchange rates — and therefore to achieve domestic

macro policy objectives. They have also made it more difficult to tax capital, which has tended to shift the fiscal burden on to other factors of production, notably labour, and/or to erode the tax base. Government attempts to prevent erosion of the tax base by raising consumption taxes tend to have a regressive impact, i.e. to increase inequality, as well.

While this weakening of national policy sovereignty arguably contributes, along with financial globalisation and deregulation, to enhancing the efficiency of financial markets — some also see it as a useful discipline on governments, as reducing politicians' and government bureaucrats' ability to tax and spend, and to distort markets[10] — it means that countries without efficient and profitable financial markets and institutions tend to suffer. They tend to lose investment, and they often raise domestic interest rates in trying to attract capital. Domestic investment suffers, and governments find it increasingly difficult to supply goods and services with an important "public good" component (which the market alone tends to undersupply), such as education and modern infrastructure, which are needed to raise productivity, and to attract productive investment.

Events in one country can also very quickly affect other countries, and big "mood swings" in global financial markets tend to affect all countries, whether or not they reflect underlying economic conditions in any particular country. Because highly mobile financial capital is responsive to regulatory differentials as well as to interest-rate differentials among countries, there has also been a tendency toward *competitive deregulation* among countries — compared by some to the competitive devaluations of the 1930s[11] — which further weakens the economic influence of governments. Competitive deregulation, fanned by what is sometimes called regulatory arbitrage, tends to put downward pressure on labour standards, as well as to amplify the shifting of the fiscal burden away from capital and the weakening of the tax base, noted earlier, and it undermines governments' ability to engage in redistributive policies (reflected in the virtual demise of the "welfare state"). Some thus see financial globalisation, and the process of competitive deregulation it has engendered, as undermining the nation state; some even see it as a security threat[12]. A growing number see it as calling for policies that "throw sand in the wheels" of international finance, if only to restore a modicum of autonomy to public monetary authorities, and of exchange-rate stability[13].

Financial globalisation and deregulation have also affected the physical location of production of goods and services. The size and the volatility of exchange-rate fluctuations among the major currencies have induced a growing number of globally competitive firms to seek to match more closely their outlays and revenues in each of the major currency areas. The result, as those firms

develop international sourcing networks for parts, intermediate goods and services, is that they tend to seek to develop those networks within each of the major currency areas, i.e. to develop international sourcing networks intraregionally rather than interregionally. Indeed, while it makes sense today to speak of a globalisation of markets, of competition, and of many corporate functions, including financial management and the creation of global corporate systems, it is not correct to speak of a globalisation of production per se: the trend in production is one of regionalisation, not globalisation[14].

Opening of Non-OECD countries. The move by non-OECD countries, both developing and ex-socialist, to privatise, liberalise and deregulate their economies over the last decade has been massive and far-reaching — for many a sea change. Until the 1980s many pursued inward-oriented growth strategies, relied heavily on state-owned enterprises, and had highly protected and regulated economies. Only a handful of relatively small economies — the Asian NIEs — successfully pursued strategies of export-oriented industrialisation, and even they were relatively protected and regulated (Hong Kong and to some extent Singapore were more the exceptions than the rule even among the NIEs). Today most non-OECD countries hope to emulate the manufacturing export success of the NIEs, and have moved to reduce import barriers, attract foreign investment, privatise state-owned companies and carry out domestic regulatory reform. China since 1979, India since the mid-1980s and especially since 1991, Indonesia and most of Latin America since the mid-1980s (the latter especially in response to the debt crisis), and Eastern Europe since 1989 are all important cases in point. Korea and Chinese Taipei are also moving to deregulate and liberalise their economies.

The remarkable shift by non-OECD countries to greater reliance on, and exposure to, global markets is accompanied in many by democratisation or political liberalisation (China remains a notable exception). The process thus increases not only their economic vulnerability, but in many cases their political vulnerability, to events in the global market. It also raises their exposure to protectionist pressures in OECD countries (thereby heightening as well their concern about the risk of exclusion from the major *de jure* regional groupings) at a time when those pressures have risen. It also can tend to widen domestic wage and income disparities. The domestic costs of deregulation and liberalisation can generate resistance from entrenched special-interest groups, to which domestic governments may find it difficult to stand up. Both the actions of special-interest groups, and especially growing inequality, can generate political instability that may threaten not only democratisation, where it is occurring, but the very process of economic reform.

From an OECD perspective, the massive opening-up of non-OECD countries is seen by some as stimulating competition and opening vast new areas for investment and growth. Unfortunately, many others see it mainly as a threat, especially insofar as they believe that trade with and investment in those countries are siphoning off jobs and depressing living standards at home.

The Environment. The rather sudden emergence, in the latter half of the 1980s, of broad-based public concern over threats to the global environment, particularly "global warming" and ozone depletion, has drawn considerable attention to "globalisation". Perhaps even more than the globalisation of financial markets, this concern has heightened public perceptions, especially in OECD countries, that even the most powerful governments now find it difficult to govern economic forces, and that those forces can have seriously detrimental effects to welfare on a global scale. It thus also feeds perceptions of increased international interdependence, of diminished national policy autonomy, and of globalisation as a threat to security and living standards.

End of Bi-polarity. The perceived threat of communism acted as a kind of security glue helping to hold the postwar capitalist system together at times of economic stress among allies. The demise of bi-polarity thus bolsters perceptions of real or latent instability and economic uncertainty. This has become the case particularly since 1989, with the implosion of the Soviet Union and the end of the Cold War. The dissolution of bi-polarity has two other important features. One is the perceived declining trend since the 1970s of US postwar economic hegemony and political leadership vis-à-vis Japan and Europe, and the closing of the gap between US firms and Japanese and European firms in terms of technological and managerial prowess. The other is the growing share of non-OECD countries in global economic activity, particularly fast-growing Asia, where China, with its huge population and low wages, is sustaining remarkable growth of output and exports — and India and Indonesia are now opening up as well[15].

Globalisation of Corporate Activity. The explosive growth of multinational manufacturing corporations in the 1950s and 1960s mostly involved oligopolistic competition *within* the economies hosting investments by those corporations. In fact, to a significant extent, that growth was driven by an overseas extension of oligopolistic competition among large US firms, while few non-US firms were able to compete successfully in the US market.

This situation changed in the 1970s. A growing number of European and Japanese firms were rapidly closing or had closed the "technology gap" and began to compete successfully in the US market. More and more US firms, squeezed between slowed domestic productivity growth and growing competition in their

home market, moved to locate some labour-intensive segments of production for the US market in a number of low-wage countries in Asia, Latin America and the Caribbean. FDI was the main vehicle for that redeployment in some industries, mainly electronics and to a lesser extent auto parts, whereas international subcontracting with locally owned firms was the main vehicle especially in clothing, sporting goods and toys[16]. Japanese firms' industrial redeployment to lower-wage countries in Pacific Asia increased during this period as well, though much of the production was for the US market, and later also for Europe; this redeployment occurred largely in response to rapid wage increases in Japan, revaluation of the yen, and growing US and European non-tariff barriers against Japanese exports. To a lesser degree European firms, especially German firms, followed a pattern similar to US firms, with production redeployed mainly to North Africa and the Mediterranean, Central and Eastern Europe (under communism) and Asia.

This acceleration of industrial redeployment in the 1970s increased substantially OECD manufactured imports from a number of developing countries, notably in Asia (countries which came at this time to be called the "NICs"[17]). Those imports became a source of concern after the mid-1970s, especially in the United States but also in Europe, because just as the level of those imports became no longer trivial, and US trade with the NICs shifted from a surplus to a deficit, stagflation and high unemployment hit the US and European economies.

Industrial redeployment carried into the 1980s, but with flagging momentum. It was supported, especially in the United States, by the radical increase in interest rates in the late 1970s and early 1980s, which was an important new source of pressure on corporate profits, and also to some extent by the recession of the early 1980s. In Europe, high interest rates and slow economic growth in the early 1990s provided some fresh impetus to industrial redeployment in the late 1980s and early 1990s — mainly in France, whose firms were slow to redeploy production before the mid-1980s[18]. In Japan, significant increases in the value of the yen both in the late 1980s and in the mid-1990s have induced, and are inducing, firms to shift more and more production offshore.

Contrary to popular perception, however, and notwithstanding the phenomenal growth of manufactured exports by China, industrial redeployment from OECD countries to developing countries and the NIEs did not accelerate, but decelerated, in the 1980s. This deceleration is visible in data on manufactured imports from the developing countries and NIEs as a share of total OECD consumption of manufactures, data which also show that those imports still account for less than 2 per cent of total OECD consumption[19]. OECD manufactures

trade with the developing countries and NIEs as a group (though not with the NIEs alone) also remains in surplus; and while growing fast, that trade remains much smaller for OECD countries than is their trade with other OECD countries[20].

The partial recovery of productivity growth in OECD countries' manufacturing, and the recovery of corporate profits, furnish part of the reason for the deceleration of redeployment in the 1980s. Also important has been the declining trend in the share of variable, low-wage labour costs in firms' total costs — a share crudely estimated to have fallen from an average of about 25 per cent in the mid-1970s to between 5 and 10 per cent by the late 1980s[21] — due not only to mechanisation and labour-saving technology, but to phenomenal increases in spending on both R&D and global marketing (establishment of global distribution networks, global brandnames and global advertising) which are essentially fixed costs. Further reasons include the growth of flexible production (discussed below), the increased importance of proximity between firms and both their customers ("global localisation") and their suppliers, especially in assembly-type industries (the ones most prone to redeployment), and advances in automation technologies that give a new measure of flexibility to production in OECD countries.

The globalisation of corporate activity today thus does not show any significant acceleration of industrial redeployment to low-wage countries by OECD-based firms. The main features of that globalisation lie elsewhere. One is the explosive growth of FDI among OECD countries (with the exception of Japan, which has become a major outward investor but not a significant host to inward investment), especially in mergers and acquisitions in the latter half of the 1980s[22]. Another is the globalisation of markets, and of inter-firm competition, as the rapid growth of firms' fixed costs combined with the acceleration of both technological change and product obsolescence has pushed many firms to seek aggressively to develop markets worldwide, i.e. in all the major regions, in order to cover those (high) fixed costs as quickly as possible. A third is the rapid proliferation since the early 1980s of "strategic" inter-firm alliances (which blur the traditional boundary between competition and co-operation) mainly between OECD-based firms especially in R&D and/or marketing-related activities. Singularly important is the emergence of the *network enterprise*, a distinctive microeconomic organisation that many experts believe is potentially superior to both "hierarchical" (i.e. intra-firm) and market ("arm's length") forms of organisation in handling market imperfections, chiefly in knowledge and other such intangible value-creating assets that have important "public good" features[23]. Those assets have become particularly significant as production has become more knowledge-intensive, and innovation and flexibility have become the keys to competitiveness in global markets.

Five inter-related sets of phenomena, deregulation, new technologies, financial globalisation, sweeping policy re-orientation in non-OECD countries, and the changing dynamics of oligopolistic inter-firm competition in the leading economies, have thus played central roles in facilitating, spurring and shaping the new wave of globalisation since the late 1970s. They have also been important, along with concern for the environment and the end of bi-polarity, in shaping public perceptions of globalisation. They go a considerable way towards explaining the specificity of globalisation today. But they do not go far enough.

For policy formation, it is important to come to grips with the microeconomic forces that drive and shape globalisation. Just as the global spread and development of Taylorism drove globalisation in the 1950s and 1960s, so do the spread and development of post-taylorist "flexible" forms of organisation drive and shape globalisation today.

3. Flexible Production and the Crisis of Taylorism

The origins of flexible production precede the current wave of globalisation. Indeed, not all OECD-based firms seeking to overcome the rigidities of Taylorism turned to low-wage production sites "offshore". Some of those firms succeeded, over time, in developing more flexible forms of organising production at home (Toyota, starting in the late 1950s, and the clusters of small and medium-size firms in the "Third Italy" in the 1960s and 1970s, are probably the best known examples[24]). The late 1970s and early 1980s, however, mark the watershed when the formidable dynamism and competitive strength of flexible producers led many taylorist firms to start talking about the "new rules" of global competition. They were reacting, above all, to the much greater capacity of flexible producers to take profitable advantage of the *flexible* automation technologies that began emerging in the late 1970s[25]; also important was the spectacular growth of flexible Japanese automakers' share of the US auto market following the second oil shock, at a time of stagnant demand growth, in the early 1980s.

Thus began the current and on-going crisis of Taylorism. In hindsight, the first signs of this crisis date from the late 1960s, when US productivity growth began to slow. The acceleration of industrial redeployment during the 1970s, which, was an international extension of the internal logic of taylorist production, can also be seen as a reflection of the building crisis of Taylorism, especially in the United States. The maturing of flexible production, especially with the development of flexible automation technologies, has greatly increased the competitive pressures on taylorist firms in the 1980s and 1990s, accentuating the crisis.

Deregulation and the globalisation of corporate competition and co-operation have further amplified those competitive pressures and the crisis of Taylorism in the leading economies. Poorly understood by many international economists, the crisis of taylorist organisations is also an important cause of the "structural" labour-market problems in OECD countries that many people there associate with "globalisation" — and more than a few mistakenly blame on imports from developing countries[26].

What is "Flexible" Production?

Flexible organisations significantly reduce waste and increase the productivity of both labour and capital by reversing the logic of Taylorism. They do so above all by *integrating* "thinking" and "doing" at all levels of operation, and in doing so eliminate many layers of middle management, which are dysfunctional in terms of information flow. Flexible organisations also avoid excessive specialisation and compartmentalisation by defining multi-task job responsibilities (which calls for multi-skilled workers) and by using teamwork and job rotation. In contrast to Taylor's "one best way", they also emphasize *continuous* innovation in the organisation of production, as well as in products and product features.

To a significant degree flexible organisations successfully combine the advantages of craft organisations and taylorist organisations while avoiding the main drawbacks of both: they merge flexibility, high product quality and a degree of customisation, which are the strengths of craft production, with the speed and low unit costs of mass production. Whereas taylorist producers can attain much higher levels of productivity than craft producers through economies of scale in the production of huge quantities of standardised products, flexible producers can attain significantly higher productivity levels than taylorist producers through economies of scope in the production of a diversity of more customised products (or services) without sacrificing economies of scale. Above all, they increase productivity by more fully exploiting the human capabilities of their workers, individually and collectively, especially for perceiving and diagnosing problems, for creatively finding solutions, and for adapting to changing circumstances. Flexible organisations combine higher productivity levels and greater responsiveness to market demands — responsiveness both in the sense of supplying a greater diversity of products and product features (more "customised" products) at a given time, or for a given level of output, and in the sense of responding much more quickly to changes in consumer tastes. Together, higher productivity and greater responsiveness to market demands make successful flexible organisations very powerful competitors vis-à-vis even the strongest taylorist organisations.

In the automobile industry, for example, which has been most extensively studied, the leading flexible producers in the mid-1980s (Toyota and other "lean" Japanese automakers) were found to have productivity levels literally twice those of the leading US and European automakers[27]. Equally impressive differentials in productivity levels and competitiveness have been reported by studies looking at flexible producers in other industries[28]. Indeed, flexible production is not limited to assembly-type manufacturing industries, such as automobiles, electronics, machinery, clothing, footwear, furniture and toys. It exists in processing industries, such as steel and chemicals, and in ceramic building materials, textiles and high-fashion silks. It also occurs in many modern services, including banking, insurance, telecommunications — and even such traditional public monopolies as electric power distribution and the postal service. It is best understood, simply, as a philosophy of human organisation.

There are two broad types of flexible organisation. One is the large-firm variety, or intra-group approach to flexibility within large organisations that characterises Japan's "lean" automobile and electronics producers and a number of large firms in Germany as well as a small but growing number in the United States (e.g. Hewlett Packard and Motorola). The other type is the "industrial district" that clusters often significant numbers of relatively small independently owned firms that actively compete but also co-operate with each other through non-arm's-length relations in close physical proximity. Both types can also be called "network enterprises".

Flexible production is a dynamic and continuously changing system, due largely to its own internal emphasis on continuous innovation in the way things are done, as well as in what is produced. This contrasts with the taylorist emphasis on "one best way" (which in many taylorist organisations led to a neglect of production per se, as illustrated in the widespread tendency for top management to come from finance, accounting or marketing rather than production). Such continuous change also makes it difficult empirically to delimit the universe of flexible organisations, or to measure their share of aggregate output. This measurement problem is compounded, because the relevant data are often produced according to precepts and categories that reflect a taylorist view of economic activity: witness the blurring under flexible production of the distinction between production and non-production workers, or between manufacturing and services — as manufacturers increasingly provide services and service firms increasingly link up with manufacturers — and even the blurring of the boundary of the firm itself, as alliances and networks supersede both markets and hierarchies as a superior form of organisation in a growing number of cases.

Taylorist organisations still prevail in terms of their share of global output. In the automobile industry, not only the best studied but also among the most advanced in terms of the degree of industry-wide development of flexible production, taylorist units still accounted for a good half of world output in the late 1980s[29]. In Japan, where flexible production probably is more widespread than elsewhere, crude estimates suggest that it accounts for about a third of GDP[30].

Significant resistance to change in taylorist organisations (discussed below) also suggests that the transition to flexible production is not likely to be quick or easy, especially in the OECD countries where Taylorism is most developed — and most entrenched. The considerable robustness of taylorist organisations relative to flexible organisations, in terms of their ability to absorb (and greatly increase the productivity of) low-skilled workers, including illiterate peasants emigrating from agriculture, and in terms of their ability to function even without well functioning infrastructure, also suggests that Taylorism still has considerable potential as a basis for organising production and achieving productivity growth in many developing countries[31]. One must therefore be cautious about predicting a rapid shift to flexible production in either OECD or developing countries.

The importance of specific features of flexible production also varies across firms (for a given level of development of flexible production) as well as across industries and countries, and over time even within a given firm. Indeed, the notion of "one best way" is alien to flexible production. Nevertheless, a number of features typically distinguish flexible from taylorist organisations:

Work organisation. All workers, not just a staff of experts, look for ways to improve production methods as well as products and services. This requires delegating a maximum of tasks and responsibilities to employees involved in production, along with a comprehensive information system that allows everyone to understand and evaluate the overall situation in the company or workplace. Full, unobstructed information flows are critical.

In large firms, workers are often organised into flexible, relatively self-managed teams which make collective decisions on how to manage production, or that part of it for which they are responsible. In manufacturing this normally includes equipment repair and maintenance, ordering materials, and quality control. Machines are typically organised into product-focused cells, as opposed to the classic assembly line, and design and production tend to be integrated through face-to-face co-operation between designers and producers, which reduces wasted time and materials — and thus the time and cost of bringing new products to market as well — while product design usually builds in "manufacturability", which also cuts costs.

Such multi-task work calls for workers with multiple skills, some of which are relatively firm-specific and need to be developed on the job. In hiring, managers look for workers with strong "basics" — literacy and numeracy skills — and also for the social and interpersonal communications skills required for effective teamwork; they look for "trainability" and an ability to work with others, rather than for workers with the skills or experience of narrowly defined specialists.

Flexible organisations also treat at least a core group of workers as long-term assets, in which they continually invest, rather than as variable costs, as tends to be the case in taylorist organisations. Workers' pay also tends to be more closely tied to group performance (e.g. through bonuses) and there are fewer wage grades.

The high level of worker involvement has multiple benefits: it mobilises all available knowledge and experience in the organisation, enhances personnel development through continuous learning, and strengthens employees' sense of identification with the organisation and its performance. Compared to the monotonous work typical of taylorist organisations it reduces alienation and enhances motivation, though it often creates more stress as well.

Just-in-time delivery systems, about which so much has been written, involve more than reducing or eliminating the often sizeable financial costs of carrying large inventories. They greatly increase flexibility and speed in matching production (of outputs and inputs) with changing market demands, and lowering minimum efficient scales of output (facilitating efficient small-batch production). They also introduce the discipline of *total quality control*, which requires building quality into the product rather than coping with defects after they occur, in inputs or output. This "zero buffer" principle (which can apply in services as well as in manufacturing) nevertheless requires highly efficient and reliable communications and transportation linkages between firms and their suppliers and customers, which greatly enhances the benefits of physical *proximity*.

Inter-firm relations. Just as core groups of workers are treated as long-term assets, so are relations with core groups of suppliers. Collaborative non-price-regulated relations that require relatively secure long-term commitments and favour mutual information feedback tend to prevail between firms and their suppliers, and the latter often play an active role in designing the products they supply. The resulting network organisation gains the advantages of size required for economies of scale and scope without the rigidity, bureaucratic inertia, and breakdown of internal communications that tend to plague large organisations. Continuous interfacing and strong two-way information flows further enhance the advantages of proximity between firms and both their suppliers and customers.

In sum, the “secret” of flexible production is not technological *per se*, but organisational. Flexible automation technologies strengthen the competitive advantage of flexible firms vis-à-vis taylorist firms because of flexible firms’ organisational characteristics. Those characteristics facilitate both innovation and rapid response to change, as well as greater efficiency, and in doing so they increase the overall speed of change. Competition is knowledge-based and driven by innovation. Flexible organisations are learning organisations, and the role of management is to create and nurture the project teams whose knowledge and creativity create competitive advantage.

Crisis in Taylorism

The first signs of the crisis in Taylorism appeared in the late 1960s and above all in the 1970s. The crisis visibly came to a head in the early 1980s with the spectacular loss of market share by the US auto majors in their home market[32]. The reaction of top management at General Motors was nevertheless symptomatic of the failure of many large taylorist organisations to come to grips with the new competition: for much of the 1980s, GM’s top management chose to believe that the strength of their Japanese competitors derived mainly from low wage rates and low interest rates (hence low capital costs) in Japan — despite considerable evidence to the contrary[33].

The experience over the last decade of General Motors and many other taylorist “dinosaurs”, some of which had dominated their industries for decades and suddenly found themselves suffering major loss of market share, illustrates the difficulty of making the transition from taylorist to flexible production. The difficulty often stems from resistance within the taylorist organisations themselves, which often is strongest at the level of management. It often starts with top managers who built highly successful careers putting taylorist precepts into practice, and for whom it can be difficult to perceive problems, much less solutions, other than through “taylorist eyes”. Resistance by middle managers tends to be very strong, perhaps more understandably, because their jobs are likely to disappear or to be changed beyond recognition in any transition from taylorist to flexible production. Many skilled workers also see threat, because their skills, often accumulated through years of experience, may be too narrowly specialised for the needs of flexible production[34]. Unskilled workers are threatened because flexible organisations have little use for workers who lack strong basic literacy, numeracy, social and interpersonal communications skills, and especially “trainability”.

This resistance to change also shows up in government regulatory policies and behaviour, and in protectionist pressures, mainly because of the actions of entrenched special-interest groups combined with voters' understandable resistance to change when they see it mainly as a threat. A further reason may be that governments are taylorist organisations; many of our governing institutions — not to mention international organisations — are plagued by the rigidities and compartmentalisation of Taylorism. This resistance to change in the face of corporate downsizing, growing wage disparities, high unemployment and widespread perceptions of growing economic insecurity often leads to a search for scapegoats — notably "globalisation," immigration, and imports from developing countries.

The extent to which the freeing of resources (because of the greater productivity of flexible production) contributes at any given time to employment-creating growth or rather to more unemployment, depends significantly on the relationship between the levels of demand and capacity utilisation, both globally and in specific industries. Many factors — including interest rates, fiscal deficits, the need to increase US savings, slow growth in Japan, and expectations, in turn affect demand growth in the world's major markets. The intensification of competition in industries whose markets in OECD countries are relatively saturated, such as automobiles, electronics and steel, nevertheless does not augur well for the reduction or elimination of "structural" unemployment and growing wage disparities in OECD countries any time soon; high unemployment and growing wage disparities in turn point to continued, perhaps growing, pressures for protection from imports and for "managed trade" — precisely at a time when the opening of non-OECD countries should be seen in OECD countries as a vital new source of demand growth. Those labour-market problems in OECD countries also highlight the danger of international frictions of a kind the new World Trade Organisation may find difficult to resolve — the call for international labour standards is only one example, which is in turn partly reflected in the growing pressure for "deep" international policy integration, and for *de jure* regionalisation.

In sum, the crisis of Taylorism, the competitive strength of flexible production, and resistance to change in OECD countries, especially in large taylorist organisations, all contribute to OECD labour-market adjustment problems — problems that became particularly visible when growth slowed in those countries in the early 1990s. Insofar as the transition to flexible production and (therefore) the crisis of Taylorism in OECD countries is prolonged, those "structural" labour-market problems are likely to persist. For OECD policy makers, especially in the United States and Europe, this points to the importance of avoiding — and denouncing — the use of scapegoats, while pursuing policies that facilitate the

transition to flexible production in ways that share the fruits of that transition, and of globalisation, with all members of society. We return to those policies in Section 5.

Implications for Developing Countries

The tremendous jump in productivity levels achieved by taylorist organisations over craft organisations arose above all from the perfection of interchangeable parts, which eliminated the need for skilled fitters in advanced manufacturing industries and opened the way for the development of assembly-type production employing large numbers of relatively unskilled workers. Enhanced by Taylor's "scientific management" techniques and Ford's invention of the moving conveyor belt, economies of scale in production gave rise to economies of scale in plant size as well. With increasing returns to scale in production and plant-size came the importance of market-share, oligopoly, and the competitive advantages of large firm size. Because these three dimensions of scale, production, plant size, firm size, have increased together with the development of corporate capitalism, there is a tendency to see them as necessarily linked. Flexible production can change this relationship as well, with important consequences for developing countries.

Flexible organisations generally produce efficiently a much wider range of products in a single plant than do taylorist organisations, and their minimum-efficient level of output for a given product is often significantly lower[35]. The result has great potential importance for developing countries because of their often limited market. Flexible organisations offer considerably greater possibilities to adapt both product features and output levels to demand requirements specific to relatively small markets, without sacrificing quality or efficiency, both of which tend to be sacrificed by taylorist organisations when they operate behind high protectionist walls to serve segmented local markets in developing countries (often producing standardised products designed for developed country consumers). Smaller minimum-efficient scales of production can also favour healthy price competition in smaller markets, insofar as they reduce the number of "natural monopolies"[36], thereby favouring domestic productivity growth as well.

Because the key to flexible production is organisational, not technological *per se,* the essential changes required in firms, and countries, that seek to make the transition from taylorist to flexible production, or to develop flexible production, are neither capital-intensive, nor therefore, for developing countries, foreign-exchange intensive[37]. The relative financial instability and, in recent years, high real interest rates in many developing countries also put a premium on

flexibility, and hence on flexible producers' greater ability to produce in response to actual demand rather than to (unreliable) demand forecasts, and on their much smaller inventories and reduced waste.

Finally, that taylorist production has not constituted a foundation for economic development in developing countries in the way it has in the developed countries means that taylorist organisations, and taylorist thinking, may not be as entrenched in developing countries. Indeed, many developing countries may benefit from greater flexibility, both in outlook and in the economy, than exists in many developed countries. However, one should not underestimate the extent to which developing countries suffer from the rigidifying actions of entrenched rent seekers, oligopolists and "distributional cartels", which are often considerably more powerful in developing countries, relative to the size of the local economy, than in developed countries.

The good news, then, is that in important respects flexible production is well suited to developing countries, especially in production for local markets where low minimum-efficient scales of production are important. There are caveats, and bad news, too.

First, while minimum-efficient levels of production can be significantly lower under flexible production than under taylorist production, those levels often remain high relative to effective levels of demand for many products in developing countries. Export-oriented development strategies and access to OECD markets thus remain important for successful flexible producers in developing countries, though the advantages gained from proximity between firms and both their customers and suppliers also point to advantages for developing countries in pursuing greater integration among themselves, as a complement to, or as a means to help strengthen, greater integration with developed countries.

Second, lower minimum-efficient scales of production and plant-size do not entail a reduction in the advantages to be derived from large firms, or a trend towards smaller firms *per se*. Flexible production means, first of all, a shift towards the network enterprise, which makes it problematic to compare the size of taylorist and flexible organisations. But the importance of economies of scope under flexible production means that the advantages of large firms apply to network enterprises, and the often large size of fixed costs, in R&D or in gaining access to technology, in marketing, in worker training, etc., means that those advantages are often significant. They point to the importance for flexible organisations of size in financial and marketing terms, while avoiding the internal rigidities typical of large taylorist organisations. Industrial clusters may provide the solution in some cases. But for many firms in developing countries and NIEs that

aspire to become, or remain, successful competitors in the current context of globalisation, the solution may lie in establishing tie-ups with or attracting investment from flexible organisations in OECD countries.

Third, and perhaps most serious, successful flexible production demands both a well-functioning modern transportation and communications infrastructure and strong human capital resources. Many developing countries find it difficult to meet the infrastructure requirements, which raises serious questions about the viability of flexible production in developing countries, notwithstanding the evidence of a number of successful flexible organisations in such countries as Zimbabwe, India and Indonesia[38]. The human-resource requirements of flexible production can also seriously constrain its development, though the importance of on-the-job skill acquisition in flexible organisations means that it is less the paucity of skilled labour than of workers with basic numeracy and literacy skills ("trainability") that is likely to pose the constraint in many developing countries. The more "consensual" approach to work organisation in flexible production also raises difficult-to-answer questions about the adaptability of the system to social and political as well as economic conditions in countries where extreme social inequality, political instability and/or undemocratic political institutions prevail.

In contrast, the greater robustness of taylorist organisations, compared to flexible organisations, is not only reflected in their ability to absorb productively greater quantities of unskilled labour. They also tend to be less demanding of infrastructure requirements, and less vulnerable to certain internal frictions, than flexible organisations. That robustness means, in short, that taylorist organisations may remain better adapted, in important respects, to conditions in many developing countries.

Nevertheless, the development of flexible production in the developed countries raises serious questions about the long-term viability for developing countries of industrial growth strategies based on taylorist, low-skilled, labour-intensive production of manufactures for global, and especially OECD, markets. Those strategies increasingly must recognise the importance for all firms, not just OECD-based firms, of proximity to their customers ("global localisation") and to their suppliers (reflecting the benefits of continuous information exchange, reinforced under just-in-time systems). The declining share of low-skilled, labour costs in total production costs and the impact of flexible automation technologies on the competitiveness of production in OECD countries also weaken those strategies. As flexible production spreads in OECD countries, it becomes more difficult for developing countries and NIEs successfully to pursue manufacturing export growth on the basis of comparative advantage in low-skilled, labour-intensive products alone, at a time when many developing countries have recently

changed strategies and are hoping to do just that. Already, the importance of proximity, reinforced in some cases by protectionist pressures in OECD countries, means that firms in NIEs and developing countries that want to compete in OECD markets increasingly find it necessary to invest in the establishment of production capabilities in those markets.

Combined, these trends suggest that for many developing countries, the risk of exclusion from the growth dynamics of globalisation in the developed countries is significant. What remains to be seen is the extent to which flexible production will take root and grow in developing countries, whether to serve domestic markets, OECD markets, or both.

4. Regionalisation

International policy debate over the last ten years has actually focused more on regionalisation than on globalisation. Economists tend to see globalisation as enhancing global welfare because they see it increasing the possibilities for efficiency gains through greater international specialisation and above all by giving freer rein to the forces of competition in global markets — forces that help channel the energies of people and the resources of countries into activities where they are likely to be most productive. They see regionalisation, however, as capable of being either good or bad, with the outcome also more directly dependent on the action of policy makers. The considerable difficulty to conclude the Uruguay Round of multilateral trade negotiations, and the remarkable proliferation of *de jure* regional agreements since the mid-1980s, starting with the Single Market in Europe and including NAFTA, Mercosur (in South America), the 1992 ASEAN Free Trade Agreement (AFTA) and others, have also focused attention on regionalisation.

Economists judge a *de jure* regional agreement as good insofar as it is "trade-creating", i.e. it reinforces globalisation by lowering policy impediments to trade within a region. They judge it as bad if it is "trade-diverting", i.e. it works against globalisation by favouring trade within a region at the expense of trade with countries outside the region. A further concern in the latter case, beyond the welfare loss due to trade diversion (a loss that could be expected to fall disproportionately on the many developing countries left out of the major regional groupings), is the risk of *degenerate regionalism*, i.e. an escalation of regional accords leading to a fragmentation of the global trading system into a number of closed and relatively hostile regional blocs. The risk of both markedly trade-diverting regional agreements and degenerate regionalism, the cost of

which could also be expected to fall disproportionately on weaker countries left outside the major blocs, not to mention the danger of inter-bloc frictions escalating into open conflict, has been reduced, but not eliminated, by the conclusion of the Uruguay Round and the creation of the World Trade Organisation.

Much of the economic policy debate over globalisation and regionalisation has thus focused on two closely related questions: (i) Are the major regional agreements trade-creating or trade-diverting? and (ii) Do they work for or against a more open world trading system? The answers are not clear-cut. While the data on actual trade patterns are consistent with a benign (not trade-diverting) interpretation because they show *inter*regional trade growing about as strongly as *intra*regional trade,[39] debate over the second question, in particular, remains inconclusive[40].

From a policy perspective, the debate over regionalisation draws attention to the importance, particularly in OECD countries, of remaining vigilant to ensure that regional agreements do not somehow become instruments for increasing protection at the regional level, in response, for example, to political pressures created by domestic unemployment. In stressing the dangers of protection, the debate also highlights that trade, even with an export powerhouse like China, is a positive-sum game.

Second, the debate points up that maintaining an open world trading system has recently become much more critical for policy makers in the developing countries. Many of those countries have recently shifted from inward- to outward-oriented industrial growth strategies, and did so during the 1980s, when OECD countries increased their use of non-tariff barriers to imports, often targeted against products in which developing countries have, or seek to acquire, significant export capabilities. Third, because bargaining power in multilateral trade negotiations depends largely on market size, interest in the debate also reflects the fact that a *de jure* regional grouping should have greater bargaining power vis-à-vis third countries than any of its members individually.

The last two of these observations go far towards explaining the strong interest shown today by policy makers in developing countries for joining one of the big regional integration schemes, and/or for creating a scheme of their own (examples of the latter include Mercosur and AFTA, and the controversial Malaysian proposal to create an East Asian Economic Caucus). They also point up the sharp contrast between the logic of the largely unsuccessful regional integration schemes among developing countries during the period from the 1950s to the 1970s, when many Latin American and African countries sought to

reduce their dependence on manufactures trade with the developed countries, and the logic of regional integration in developing countries today, which is one of strengthening their participation in that trade.

The debate, with its strong focus on trade, has nevertheless tended to miss perhaps the single most important reason why *de jure* regionalisation is important for policy makers. As a policy instrument for individual countries, a *de jure* regional agreement can, and generally must, have an internal objective as well: to weaken, disrupt or dilute the often considerable growth-retarding powers of domestically entrenched special-interest groups, oligopolies, rent seekers, what Mancur Olson has called "distributional cartels", whose actions, both in the market and through politics, tend to dampen an economy's competitiveness at home and abroad[41]. Whether or not diluting or disrupting the powers of such groups is a declared objective of regional agreements, weakening those powers is often required to stimulate the forces of domestic competition. Weakening those powers through *de jure* regional integration can thus be a key to strengthening domestic growth and competitiveness, as well as to strengthening the economy of the region vis-à-vis the rest of the world.

The Relationship Between Regionalisation and Globalisation

De jure regionalisation can thus be a political response to globalisation, and at the same time, it can help to strengthen the microeconomic forces that drive globalisation in the region by stimulating internal competition, as well as by significantly enlarging the domestic market. By weakening the power of special-interest groups *de jure* regionalisation has the potential to help member governments collectively establish, or re-establish, their policy sovereignty vis-à-vis the market internally, as well as vis-à-vis global markets. Politically, *de jure* regionalisation can also give impetus to much needed reform legislation at the national level that otherwise might not overcome domestic opposition, and in doing so, it can help open the economy to globalisation.

De jure regionalisation can also enhance member states' policy stability and credibility, because it can lead to needed reform legislation, and because an international agreement is more difficult to change than domestic legislation, which can in turn be good for macroeconomic stability, and to attract foreign investment. Indeed, the principal motivation behind many of the recent regional agreements, certainly in developing countries, has precisely been to attract FDI, more than to promote trade *per se*. Free flows of FDI between regions should offset whatever small trade-diverting effects the regional agreements may have[42].

De jure regionalisation is an efficient vehicle for responding to the growing pressure for “deep” international policy integration in a way that is difficult or impossible to achieve among countries, and peoples, that do not share a strong sense of cultural or historical as well as geographic proximity. Indeed, that pressure, for more international integration or harmonisation of traditionally “domestic” policies, which globalisation engenders, has led in recent years to a blurring of the distinction between domestic and international policy instruments.

In short, globalisation and regionalisation are opposites only in the sense that one is usefully understood as a centrifugal process and the other as a centripetal process, and in the sense that one is driven by microeconomic forces and the other is often a political phenomenon. In practice, globalisation and regionalisation tend to be mutually reinforcing, especially insofar as regionalisation stimulates internal competition.

Policy makers must nevertheless recognise that the same special interest groups that are most likely to oppose *de jure* regionalisation if it threatens to undermine their domestic rent-seeking powers, are also among the political forces most likely to seek, if they are unable to block the process, to transform it into a tool for regional protection. The inter-war period provides a dramatic illustration of such a possibility.

When *de jure* regionalisation becomes a tool for regional protection and loses its internal competition-enhancing effects — by failing adequately to disrupt or dilute the rent-seeking powers of domestic oligopolies and special interest groups — regional integration loses its value as a policy tool for strengthening regional growth and competitiveness in global markets. Moreover, whatever benefits it may bring are not even likely to justify their cost in terms of reduced national policy autonomy. On the other hand, insofar as *de jure* regionalisation strengthens internal competition, by enhancing “deep” policy integration among members and/or by weakening the rigidifying powers of entrenched distributional cartels, it can enhance member states’ collective policy sovereignty vis-à-vis the market — hence the potential effectiveness of their policy measures — while strengthening the region’s competitiveness vis-à-vis the rest of the world. In short, globalisation and *de jure* regionalisation tend to be mutually reinforcing insofar — but only insofar — as the latter stimulates intraregional competition.

Many powerful OECD-based multinational firms that might once collectively have constituted a strong political force against regional protectionism in OECD countries can no longer be counted on to play that role. Most of those firms still favour a liberal multilateral trade regime, but because many have moved, or are moving, to establish or consolidate production capabilities *within* each of the

major regions, they tend to give more importance to the lowering of *intra*regional barriers to economic activity as a whole, than they do to any perceived risk of higher *inter*regional barriers to trade. Low *investment* barriers are important for those firms, between as well as within regions, but even worst-case scenarios, in terms of the formation of relatively closed regional blocs, foresee little danger of increased barriers to interregional investment. Weaker firms, on the other hand, are more likely to be among those seeking either to block regional agreements or to transform them into tools for regional protection[43].

Globalisation today thus also stimulates regionalisation. Globally competitive multinational firms have become a strong political force for *de jure* regionalisation as a means to lower policy barriers to intraregional activity. Globalisation also stimulates *de facto* regionalisation: "global localisation" and the regionalisation of sourcing are *de facto* corporate responses to both the globalisation of financial markets (notably the volatility of fluctuations among the major currencies) and the dynamics of global oligopolistic inter-firm competition in which firms' proximity to both their customers and their suppliers has become more important as markets have become global.

Globalisation has further increased the importance of industrial clusters or "districts", which are subnational phenomena that nevertheless sometimes straddle one or more national boundaries[44]. Moreover, the redeployment of production to lower-wage production sites, a phenomenon that has been tempered but not eliminated by the development of flexible production, by the diminished relative importance of low-skilled labour costs in firms' total costs and by the increased importance of proximity to customers and suppliers, tends to consist of production for regional markets, not for global markets. Notwithstanding China's impressive extra-regional export performance, production redeployed to a low-wage site but destined to serve European consumers is more likely today to go to Eastern or Southern Europe, or perhaps to North Africa, than to Asia or Latin America; production to serve the North American market is more likely to go to a lower-wage site in the United States or to Mexico; and while production redeployed to low-wage economies in Asia, by NIE-based firms as well as by Japanese and other OECD-based firms, remains strongly oriented towards extra-regional markets, the trend is clear: such production goes increasingly to those economies to serve the fast-growing Asian market.

The dynamics of global inter-firm competition in the leading economies lead to increasing corporate pressures on governments to go beyond "shallow" international policy integration, i.e. to go beyond reducing trade and other policy barriers to international activity "at the borders", and to engage in "deeper" policy integration by harmonising a growing number of policies hitherto seen as

essentially "domestic". Differences in national (and sometimes subnational) policies on the rules of competition, financial regulations, product standards, environmental standards, labour standards, public procurement, government subsidies to science and technology, and even fiscal and monetary affairs, as well as different approaches to corporate governance, all have an important incidence on firms' ability to compete in individual markets, and have thus become the source of new tensions and conflicts among governments[45]. Many urge *de jure* regional approaches as the most effective means to pursue such "deeper" international policy integration, with multilateral institutions, notably the WTO and the OECD, playing a vital complementary role in seeking to ensure at least minimal harmony or compatibility among the regional approaches.

Finally, globalisation stimulates regionalisation today because some governments, more than others, see *de jure* regionalisation and a (greater) degree of pooling of their policy sovereignty at the regional level as a collective means to reassert that sovereignty and thereby gain, or regain, a measure of policy autonomy vis-à-vis the global market, if only to palliate some of the destabilising effects of globalisation.

Regionalisation in Europe, America and Asia

Regionalisation nevertheless has taken very different forms in each of the major regions, in each of the "poles" of the emerging tri-polar world economy. Europe has opted for "deep" policy integration among members of the European Union. The logic of the Single Market clearly is *not* one of protectionism, but of promoting competition within Europe to strengthen European competitiveness at home and abroad. For non-Europeans, the main challenge is to take advantage of whatever stimulus to European growth the Single Market provides. For developing countries and NIEs, the main challenge nevertheless comes not from European integration *per se*, but from changes in Central and Eastern Europe, and the danger of EU trade-, investment- and aid-diversion to the latter. The Central and Eastern European countries benefit from physical and cultural proximity to EU countries, and at least some degree of preferential access to EU markets, and can be expected to develop competitive strengths in manufactures that compete directly with those of developing and newly industrialising economies outside the region.

North America has followed a process of relatively shallow *de jure* regionalisation, under NAFTA, preceded by substantial *de facto* regionalisation between the United States and both Canada and Mexico. For Mexico a major motivation for NAFTA was to "lock in" the country's far-reaching policy reforms,

and to attract foreign investment. For countries outside the region, NAFTA's significance lies primarily in the risk of diminished US commitment to multilateral trade liberalisation, and the agreement's potential to divert trade and investment to Mexico. It has also added to incentives for other developing countries to form subregional groupings among themselves, such as Mercosur in South America and AFTA in Southeast Asia.

In Pacific Asia, regionalisation is basically a *de facto* process, driven by strong economic growth, particularly in the region's developing countries and NIEs. The main challenge for those outside the region, both countries and firms, is to share in the benefits of that growth, which looks likely to continue for some time, by pursuing policies and strategies to develop their own competitive strengths.

5. Conclusions

Globalisation presents the main challenge today for policy makers in OECD and developing countries alike, and for firms worldwide. The challenge of regionalisation, though important, is subordinate.

Since the late 1970s, market deregulation and policy liberalisation, the new microelectronics-based information and communications technologies, and globalisation of financial markets have facilitated and stimulated a new wave of globalisation. As in the past, the dynamics of inter-firm competition in the leading economies provide its driving impulse. Flexible production now shapes those dynamics — just as taylorist production shaped them as the principal microeconomic force driving globalisation in the 1950s and 1960s.

The current wave of globalisation has generated a crisis in taylorist organisations, which still account for a sizeable share of employment in OECD countries. That crisis is an important cause of the "structural" labour market adjustment problems that now plague Europe and the United States. The liberalisation and globalisation of financial markets, and competitive deregulation, are in turn important causes of diminished national economic policy sovereignty vis-à-vis the market.

Growing inequality, both within and between countries, and a threat of exclusion faced by many people are further effects of globalisation. Combined with the crisis of Taylorism, the result in the United States is a significant decline in the real wages of many workers (hence growing numbers of "working poor") along with growing job insecurity and income disparities, the end of the "American dream" for many Americans[46], and in Europe it is high levels of "structural"

unemployment and the virtual demise of the "welfare state"[47]. In many developing countries the main threat is exclusion from globalisation and growing poverty. Even in the more dynamic developing countries and NIEs that are unlikely to be excluded from globalisation, growing income disparities, stagnant or declining real incomes and increased economic insecurity affect many people.

Large segments of the world's population face not only a threat of exclusion from the welfare gains to be derived from globalisation through enhanced productivity, but a threat of significant loss of income and of economic security. The extent to which that threat to economic security in turn creates a threat to political security (and thus to globalisation as well) should not be underestimated.

The challenge, above all, is therefore to pursue globalisation in ways that do not weaken, but rather strengthen, social cohesion. All segments of society, within countries and between countries, must share in the benefits, and perceive themselves as standing to gain, from the enhancement of productivity that accompanies globalisation. The challenge is amplified by the extent to which globalisation today increases the political vulnerability of both OECD and non-OECD governments to events in the global market. It requires close attention to the microeconomic features of globalisation.

For OECD countries, the imperative is mainly to increase domestic flexibility, and to do so in ways that favour social cohesion. This is first and foremost a task for firms and managers, but governments and labour organisations face it as well, not least because they too are often organised along taylorist lines. Many kinds of organisations need to move beyond taylorist management and organisational precepts and the dichotomy of markets and hierarchies in order to embrace the transition to flexible forms of organisation, which may include promoting greater social cohesion within the organisation if only to enhance its internal flexibility. Resistance to change within the organisation, and blindness to the type of change required, often present the main obstacle. The tendency instead is often to look for scapegoats, notably in "globalisation" and the redeployment of production to developing countries.

The OECD countries need policies to facilitate and encourage the transition to flexible production and the development of flexible organisations, and to do so in ways that favour social cohesion. They should facilitate and promote microeconomic flexibility rather than succumb to pressures to resist change through protection or other measures to restrict competition. Policies should promote social cohesion not only because the cost of rapid change without it can be high (political instability, demotivation, drugs, crime) but because it fosters

creativity and innovation and facilitates change in firms and in society. Weak or declining social cohesion, on the other hand, increases resistance to needed change, and prolongs and exacerbates the crisis of Taylorism.

Policies to facilitate and stimulate needed change at the microeconomic level start with macroeconomic policies that favour low interest rates and strong growth without inflation. Such policies favour investment and new firm start-ups, hence flexibility, and can create a virtuous circle because microeconomic flexibility also makes macroeconomic policies more effective. High interest rates and slow growth limit change and slow the development of flexible organisations while aggravating the crisis of Taylorism.

"Structural" policies should focus on the development of human capital, on the creation and diffusion of both technological and organisational know-how, and on nurturing an entrepreneurial climate[48]. Governments can, for example, facilitate firms' absorption of new technologies and nurture an entrepreneurial climate through measures that promote investment in new information infrastructures (e.g. remove regulatory barriers to market access and establish adequate standards to stimulate the creation of new and more effective services) and through measures that make better use of public procurement (e.g. encourage innovation through performance requirements, break-up contract size, encourage supply consortia of small firms). Governments can foster the development of industrial clusters or "districts", rather than discourage them as often happens with incentives to firms to locate in poorer areas, and subnational governments, especially municipal governments, often have a key role to play here as well[49]. Governments should also ensure that industrial assistance does not unduly favour large established firms at the expense of new small ones. One way governments can improve the incentives for enterprises and workers to invest in education and skill formation is by changing financial accounting practices to allow skills to be treated as long-term assets.

The important "public good" features of education and human capital formation can justify direct government investment in education, and the knowledge-intensive nature of competition today probably justifies increasing that investment. But just as there is a blurring today of the boundary between manufacturing and services, between competition and co-operation, and even of the boundary of the firm itself, so is there change in what is required from public training and education systems, both in terms of their content and in terms of the boundary between public and private responsibilities. Since flexible organisations tend to require workers with *multiple* skills, and many of those skills are rather firm-specific, such organisations tend not only to treat at least a core group of workers as long-term assets rather than as variable costs; they also tend to

provide workers with much more on-the-job training, and continuous training, than do taylorist organisations. What flexible organisations need most from public educational systems, therefore, is not so much investment in the production of skilled but narrowly defined specialists, or a lot of investment in vocational training, but much more investment, and success, in the production of people with broad-based problem-solving skills, hence numeracy and literacy skills, and with the social and interpersonal communications skills required for teamwork, along with the "trainability" (preferably lifelong trainability) required for flexibility.

A lot of attention has focused on OECD labour markets. While appropriate deregulation of those markets may help in countries where regulations serve mainly to perpetuate taylorist rigidities and the rents of entrenched special-interest groups, it is also very important to promote social cohesion. Any debate over labour-market regulations and the importance of flexible labour markets should not be at the expense of focusing on how OECD governments can facilitate the development and diffusion of knowledge, improve public education, stimulate investment in modern infrastructure, nurture an entrepreneurial climate and promote sustained growth and job creation.

One must also assess international policies in the same spirit. OECD trade policies should embrace trade with non-OECD countries, as well as among OECD countries, not only because such trade stimulates competition and growth at home, and promotes global development, and because the contrary ultimately leads to sclerosis — but also because non-OECD markets are important and fast-growing, and will account for a large share of global demand growth.

Globalisation also blurs the distinction between "domestic" and international policies as it increases pressures on governments to move beyond "shallow" to "deep" international policy integration[50]. *De jure* regionalisation can be a valuable policy instrument in this regard, and can also be a valuable means to enhance competition and productivity growth, by weakening the rent-seeking powers of nationally entrenched oligopolies and special-interest groups, within a region. However, *de jure* regionalisation may not shelter countries from the volatility of global financial markets, as both the 1992-1993 European monetary crisis and the 1994-1995 Mexican peso crisis illustrate.

The challenge of globalisation probably is even greater for non-OECD countries than for OECD countries. For many it is a double challenge: first, to open up to the global economy, a sea change in development strategy and policy orientation that includes deep reductions in barriers to imports and capital flows along with far-reaching domestic reforms. It means significantly increased economic and political vulnerability to events in the global economy at a time when many

of these countries are both politically and economically vulnerable as they undertake the transition to more market-friendly economies and, in many cases, to democracy as well. The policy challenge of the transition includes finding the right answer to critical questions about the speed and proper sequence of policy reforms, such as whether internal deregulation should or should not precede external liberalisation, and about the linkage between political and economic reforms.

Second, non-OECD countries must also face the implications of globalisation in the OECD countries. As non-OECD countries open up, they must also deal with the repercussions of the globalisation of financial markets (including volatile exchange rates of the major currencies and the pressures of competitive deregulation[51]), the dangers of exclusion from the major regional groupings, and above all the changing dynamics of oligopolistic inter-firm competition in the OECD countries. They must deal with the impact of flexible automation technologies and flexible organisations, including the increased importance of proximity, the diminished importance of low-skilled labour costs, and the regionalisation of production, along with the political fallout from the crisis of Taylorism in Europe and North America, which will include protectionist pressures directed against imports from low-wage countries. Indeed, it is no small irony that just as many developing and ex-socialist countries finally turn outward and seek to become low-cost sites for production to serve global markets, a chorus of protectionist voices emerges in some OECD countries to blame unemployment and declining wages at home on a massive shift of production to low-wage countries that has not occurred[52] and is unlikely to occur.

Non-OECD countries, like OECD countries, need policies which will capture the benefits from the productivity-enhancing features and long-term growth dynamics of globalisation, and do so in ways that strengthen social cohesion. Many of the policy implications cited above for OECD countries broadly apply to non-OECD countries: pursue mutually reinforcing macroeconomic and structural policies; promote the development of human capital, and focus public investment in human resources on strengthening broad-based problem-solving skills, i.e. basic numeracy and literacy skills at the primary and secondary levels, and on developing social and interpersonal communication skills (“trainability”); facilitate the diffusion and absorption of know-how, both technological and organisational; promote the formation of industrial clusters; promote investment in the development of modern infrastructure; create an entrepreneurial climate, which in many developing countries requires a lot of attention to creating and nurturing that all-important public good called the market (often mistakenly assumed to exist through immaculate conception!), and to ensuring that markets are “contestable” (characterised by healthy inter-firm

price competition). Governments should also ensure that participation in any *de jure* regional integration schemes serves to strengthen competition within the region, including domestically.

Problems more specific to non-OECD countries include low domestic levels of development of human capital and infrastructure, low productivity and income levels, sometimes widespread poverty, and perhaps a very small effective domestic market. Externally, the declining trend in low-wage labour costs as a share of global production costs combined with the competitive strength of flexible production, the increased importance of proximity between firms and both their customers and suppliers, and the tendency for OECD countries to move towards "deeper" policy integration among themselves, especially on a regional basis, mean that comparative advantage in low-skilled, labour-intensive production is of diminishing value for a country as a source of strength for competing in global markets, relative to skills, flexibility, proximity and other competitive assets. They also point to an emerging gap between non-OECD countries whose firms are able to invest in OECD regional markets as a means of competing in those markets (especially if they themselves are not part of the region), and the many countries whose firms find it difficult to undertake such investment, with the latter increasingly threatened with exclusion from those markets.

The combined result, for many non-OECD countries, is the spectre of exclusion from globalisation. The question they face, in other words, is whether there will be a globalisation of globalisation.

Where experience points to a possible "Yes," notably in Pacific Asia and northern Mexico as regards the development of internationally competitive flexible organisations, it also points up some critical, if unsurprising, policy lessons. One is the importance of macroeconomic stability, hence of sound macroeconomic policies, combined with political stability. Another is the importance of policy credibility, vis-à-vis both internal and external economic actors. Also important is public attention to the maintenance of well-functioning transportation and communications infrastructure, as well as human capital formation, and to the question of access to OECD markets.

Recent developing-country successes in manufactured exports, notably, but not only, in China, also confirm, however, that taylorist organisations have not exhausted their competitive potential in non-OECD countries. They also show that competitive success can sometimes be achieved by combining elements of

taylorist and flexible production in low-wage countries[53]. Clearly, for non-OECD countries and firms, perhaps even more than for OECD countries and firms, there is no "one best way".

Successful flexible production in developing countries and NIEs also shows, finally, that flexible production is not something that can be purchased or imported via foreign direct investment like a capital good. More akin to a philosophy of human organisation, it is something that can and must be learned and developed locally.

International inter-firm tie-ups and inward FDI nevertheless have a crucial role to play. Indeed, a further implication of globalisation for non-OECD countries, especially for firms, is the importance of networking with OECD-based firms, and conceivably with non-OECD-based firms, that are likely to be strong global competitors tomorrow, which is not always the case of today's market leaders[54].

The importance of FDI also highlights the importance of a hospitable investment climate and policies to attract FDI, and at the same time the danger of "bidding wars" among governments (within as well as between countries) to attract FDI. Conceivably, such policy competition can induce socially beneficial increases in pubic investment in human capital formation and infrastructure; but it can easily lead to a costly and socially unwarranted escalation of direct and indirect subsidies to FDI, and/or to a process of competitive deregulation that undermines environmental and/or labour standards, for example. Both "bidding wars" and competitive deregulation can in turn have substantial perverse effects: escalating subsidies and "incentives" to FDI can exacerbate fiscal deficits and/or divert resources from public investment in infrastructure and human capital, investment that can often do more to raise economy-wide productivity and even to attract long-term productive investment; excessive and therefore unsustainable incentives and/or policy competition among governments can also create policy instability and weaken policy credibility, which results in uncertainty that can actually reduce the inflow of valuable long-term investment (it may also attract investment looking mainly for a quick profit).

Another goal for governments, national and subnational, is to increase *policy co-ordination* and *co-operation*. The danger of excessive policy competition to attract FDI, and the pressures of competitive deregulation, are but two examples of the growing importance of moving beyond "shallow integration" to "deeper" international policy integration in developing countries, as well as in OECD countries.

De jure regional agreements can be a useful vehicle to strengthen such policy co-ordination among developing countries. They can also help to attract FDI, not least because of the greater steadiness and credibility they can give to member governments' policies, as well as the larger market they offer to investors. They must, however, be designed to strengthen internal competition, and thus to stimulate domestic productivity growth. The agreements can involve national governments (e.g. Mercosur, AFTA) but they can also involve subnational governments (as in several of Asia's "growth triangles"). They can be particularly valuable as vehicles for developing "deeper" economic integration, including the cross-border development of infrastructure, as well as for deeper policy integration.

De jure regionalisation can also strengthen relations between developing and developed countries, as in NAFTA. But for relations between OECD and developing countries generally, there clearly is no substitute for a strong World Trade Organisation. Indeed, for non-OECD countries, perhaps the single greatest threat of exclusion from globalisation stems, in policy terms, from the threat of being excluded from the process of "deep" policy integration among OECD countries. That process, driven by the microeconomic forces of globalisation, will move ahead. The ultimate interest of OECD countries is to ensure that the process takes full account of conditions in non-OECD countries, and integrates them in a way that promotes social cohesion within and between countries, along with economic efficiency and growth. The collapse of globalisation from 1914 to 1945, and all that accompanied that collapse, offer a stark reminder of what can happen when market forces lead to a breakdown in social cohesion, and governments fail to respond adequately.

Notes and References

1. Some authors refer to the current period as the era of "globalisation", the 1950s and 1960s as the era of "multinationalisation" (because of the rapid growth of multinational enterprise), and the late 19th and early 20th centuries as the era of "internationalisation" (because of the strong growth of international trade and capital flows).

2. An important early example of regionalisation as a political phenomenon is the creation of the nation state, notably in England and France during the transition from feudalism to capitalism in the 16th to 18th centuries, and in Germany and Italy in the 19th century, when centralising monarchs greatly increased both their powers of state and the degree of internal integration of their respective economies by moving to eliminate or greatly weaken the locally monopolistic powers of the parochial baronies and manors, the virtually autonomous towns and the self-governing merchant and artisan guilds, the "distributional cartels" of the day, which seriously restricted trade and the mobility of capital and labour.

3. Estimates of the ratios of international trade and financial flows to total output in the leading economies during that period are considerably higher than the ratios for any more recent period, though current ratios are beginning to approach the pre-World War I ratios; those of the 1950s and 1960s remained much lower. Contributing to such relatively high levels of trade and financial flows from 1879-1914 was probably the remarkable stability of currency exchange rates (see, for example, McKinnon, R., 1993, "The Rules of the Game: International Money in Historical Perspective" in *Journal of Economic Literature*, Vol. XXXI, March). Consistent with this explanation, and somewhat surprising in its own right , is the fact that trade grew as fast in 1895-1914, when protectionist barriers were relatively high in all the leading economies except the United Kingdom, as in 1860-1880, when those barriers were significantly lower in Europe (see, for example, Dehove, M. and J. Mathis, 1986, *Le Commerce international*, Dunod, Paris).

4. It was thus in the late 1970s that the OECD undertook its first study of the impact on OECD countries of trade with the "Newly Industrialising Countries" (a term coined by that study) — a telling sign of the rapidly growing significance of that trade, much of it due to industrial redeployment, after the mid-1970s. Cf. OECD, 1979, *The Impact of the Newly Industrialising Countries on Production and Trade in Manufactures*, Paris. See also note 17 below.

5. This issue is discussed further, as regards the developing countries, in Oman, C., 1994, *Globalisation and Regionalisation: The Challenge for Developing Countries*, OECD Development Centre, Paris. For a brief recent discussion of the productivity issue in the Soviet Union during this period, see Krugman, P., 1994, "The Myth of Asia's Miracle", in *Foreign Affairs*, November-December.

6. Average annual productivity growth in the business sector (total factor productivity) slowed as follows, according to OECD data (*ibid.* Table 25): (percentage rates of growth: annual averages)

	1960-73	1973-79	1979-88
United States	1.6	-0.4	0.4
Japan	6.0	1.5	2.0
Germany	2.6	1.7	0.7
France	4.0	2.2	1.6
Italy	4.6	2.2	1.0
United Kingdom	2.3	0.6	1.8
Canada	2.0	0.7	0.3
OECD Europe	3.3	1.4	1.2
OECD	2.9	0.6	0.9

7. See, for example, OECD, 1992, *Technology and the Economy: The Key Relationships*, Paris.

8. According to less-than-satisfactory data, international mergers and acquisitions rose from $39 billion in 1986 (some 43 per cent of recorded FDI flows that year) to $131 billion in 1989 (63 per cent of FDI) and $114 billion in 1990 (52 per cent of FDI). See, for example, Jungnickel, R., 1993, "FDI: Recent Trends in a Changing World", Report No. 115, HWWA Institute Hamburg.

9. See Bank for International Settlements, 1995, "Preliminary Global Findings of the Central Bank Survey of Foreign Exchange Market Activity in April 1995", in *BIS Review* No. 180, 24 October, for estimates of global foreign-exchange transactions; the estimates and forecast of total financial assets traded are those of the McKinsey Global Institute, 1994, "The Global Capital Market: Supply, Demand, Pricing and Allocation", November. See also Greenspan, A., 1995, "The Challenges for Central Banks arising from Global Finance and Changing Technology", Remarks to the Annual Monetary Policy Forum, Stockholm, 11 April (reprinted in *BIS Review* No. 72, 28 April 1995); O'Brien, R., 1995, "Who Rules the World's Financial Markets", in *Harvard Business Review*, March-April; Wachtel, H., 1995, "Taming Global Money", in *Challenge*, January-February ; and Eichengreen, B., J. Tobin and C. Wyplosz, 1994, "Two Cases for Sand in the Wheels of International Finance", Working Paper No. C94-45, Centre for International Development Economics Research, University of California at Berkeley, December.

10. See, for example, W. Wriston (former Chairman of Citicorp), 1992, *The Twilight of Sovereignty*, Charles Scribner's Sons, New York.

11. See, for example, Cerny, P., 1994, "The Dynamics of Financial Globalisation: Technology, Market Structure, and Policy Response" in *Policy Sciences*, No. 27.

12. For example, Wachtel, *op. cit.,* sees the power of global financial markets as a serious threat to political stability, and therefore to security, because the weakening of national governments favours the re-emergence of nationalism and tribalism.

13. See, for example, Eichengreen *et al.*, *op. cit.*

14. See also Wells, L., 1992, *Conflict or Indifference: US Multinationals in a World of Regional Trading Blocs*, OECD Development Centre, Technical Paper No. 57, Paris.

15. The developing countries' share of world manufactures trade has doubled over the last decade, to about 20 per cent in 1993, according to WTO data.

16. See Oman, C., 1984, *New Forms of International Investment in Developing Countries*, OECD Development Centre, Paris; and Oman, C. *et al.,* 1989, *New Forms of Investment in Developing Country Industries*, OECD Development Centre, Paris.

17. The share of the Asian NICs (Korea, Chinese Taipei, Hong Kong, Singapore) in OECD manufactured imports rose from 1.3 per cent in 1964 to 3.9 per cent in 1973 (see also note 4), to 5.4 per cent in 1980 and 8 per cent in 1985. US trade with the NICs shifted from surplus to deficit in the mid-1970s, as did such trade for the OECD countries as a group — with the exception of Japan — in the early 1980s. (The term "NICs" was changed to newly industrialising *economies*, i.e. NIEs, in the late 1980s.

18. See Mouhoud, E.M., 1992, *Changement technique et division internationale du travail*, Economica, Paris; and Arthuis, J., 1993, *Report on the Impact of Redeployment*, Report by the Chairman of the Finance Committee to the French Senate, June. The Arthuis Report makes the important point that supermarket chains (*hypermarchés*) have relied heavily on offshore suppliers to increase their share of consumer sales in France (from 20 per cent of total sales in 1980 to over 35 per cent by 1990), and have squeezed returns on sales (and on production per se) to virtually zero because their profits, at a time of high interest rates, derive essentially from interest on cash flow. Though the Report is critical of redeployment, this observation seems to point above all to the importance for French policy makers of obtaining lower interest rates.

19. Average annual rates of growth of import penetration in OECD countries (the share of imports in domestic consumption) by manufactures from the Asian NIEs fell from the 1970s to the 1980s, according to OECD data, as follows (average annual percentage rates of growth):

	1970s	1980s		1970s	1980s
United States	14.5	10.7	United Kingdom	3.6	2.7
Germany	14.5	6.5	Netherlands	12.3	8.4
France	22.6	10.0	Japan	14.2	4.4

Import penetration by manufactures from other non-OECD countries decelerated even more markedly, and in some countries — Germany, the United Kingdom, the Netherlands, Japan — actually declined.

20. OECD data on manufactured imports from OECD and non-OECD countries in the latter half of the 1980s, as a share of domestic consumption in the OECD countries, show the following levels (percentages):

	Imports From OECD	Imports from non-OECD		Imports from OECD	Imports from non-OECD
United States	9	4.3	United kingdom	20	3
Germany	22	3	Netherlands	58	7
France	25	3	Japan	2.9	2.6

21. Direct labour now accounts for as little as 2 per cent of total production costs in semi-conductors, for example, and in standardised auto parts for a share estimated at about 10 per cent and falling (see, for example, Miller, R., 1993, "Determinants of US Manufacturing Investment Abroad", in *Finance and Development*, World Bank/IMF, Washington, D.C., and Ohmae, K., 1985, *Triad Power: The Coming Shape of Global Competition*, Free Press, New York).

22. Global FDI flows grew at the unprecedented average annual rate of almost 30 per cent from the end of the recession in the early 1980s to the end of that decade, or three to five times the rate of trade growth and as much as ten times that of global output growth. The global stock of FDI has thus quadrupled, from about $500 billion in 1980 to over $2 trillion today, and the value of sales by companies' foreign affiliates, amounting to $5.8 trillion in 1992, exceeded world exports that year by $1.1 trillion. (The annual flow of FDI fell from its peak of over $200 billion in 1990 to a cyclical low of about $150 billion in 1992, due mainly to the economic slowdown in OECD countries , but has since climbed again to slightly over $200 billion in 1994.) See also note 8.

23. See, for example, OECD, *Technology and the Economy*, *op. cit.* The concepts of "market" and "hierarchical" forms of organisation come from transaction-cost theory, in particular from Williamson, O., 1975, *Markets and Hierarchies*, Free Press, New York; and Williamson, O., 1985, *The Economic Institutions of Capitalism*, Free Press, New York.

24. See in particular, Piore, M. and C. Sable, 1984, *The Second Industrial Divide*, Basic Books, New York; Womack, J. *et al.,* 1990, *The Machine that Changed the World*, Rawson MacMillan, New York; and Best, M., 1990, *The New Competition*, Harvard University Press, Cambridge.

25. General Motors invested some $5 billion dollars in robots during the early to mid-1980s, for example, but continued to lose market share to the Japanese automakers whose flexible organisations enabled them to take much greater advantage of their (smaller) investments in (less sophisticated) robots during the same period. See in particular Womack *et al.*, *ibid.*

26. For a critique of this view, see in particular Lawrence, R., forthcoming, *Single World, Divided Nations? Globalisation and OECD Labour Markets*, OECD Development Centre, Paris.

27. Womack *et al.*, *op. cit.*

28. See, for example, Cooper, R., 1995, *When Lean Enterprises Collide*, Harvard Business School Press, Boston; Bessant, J., 1991, *Managing Advanced Manufacturing Technology*, Blackwell, Oxford; and Piore and Sable, *op cit*. See also Franken, O., 1995, "Global Industrial Transformation and Increasing Competitiveness: The Consequences for OECD and Developing Countries", mimeo, OECD Development Centre, Paris.

29. Cf. Womack *et al.*, *op. cit.*

30. Cf. Ozawa, T., forthcoming, *The Capacity to Learn: The New Production Paradigm and Developing Countries*, OECD Development Centre, Paris.

31. See Motta Veiga, P., forthcoming, *L'Industrie brésilienne dans la transition : vers un nouveau modèle productif ?*, OECD Development Centre, Paris.

32. In just four years, from 1977 to 1981, Japanese automakers' share of world production jumped from barely over 20 per cent to almost 30 per cent, at a time when US automakers were forced to cut production for their own market from over 13 million to about 7 million units per year (Womack *et al.*, *op. cit.*).

33. *Ibid.*

34. Highly specialised *skilled* machinists have been passed over for employment by managers of flexible machine shops, for example, because their skills were considered much too narrowly defined and, most important, their flexibility was seen as insufficient.

35. Evidence of lower minimum-efficient scales of production and smaller average production runs, often accompanied by smaller, minimum-efficient plants, has been reported in electronics, machinery, steel, auto parts and chemicals, for example. See, for example, Kaplinsky, R., 1993 "Is Flexible Production Relevant for LDCs?", OECD Development Centre Working Paper; Carlsson, B., 1989, "The Evolution of Manufacturing Technology and its Impact on Industrial Structure", in *Small Business Economics*, Vol. 1, No. 1; OECD, *Technology and the Economy*, *op. cit.*; and Humphrey, J. *et al.*, 1995, *Industrial Organisation and Manufacturing Competitiveness in Developing Countries*, Special Issue of *World Development*, January.

36. "Natural monopolies" occur, strictly, when the ratio of minimum-efficient scale of output to total domestic market size is greater than 0.5, since there is room for only one efficient supplier. The more general point of course is that even when a reduction in the minimum-efficient scale of production increases the maximum number of efficient suppliers that can operate in the market from, say, three to seven, competition is likely to benefit.

37. Cf. Kaplinsky, *op. cit.*

38. Cf. Kaplinsky, *op. cit.*, and Humphrey *et al.*, *op.cit.*

39. A regional grouping will not have a negative welfare impact on countries outside the grouping as long as the *volume* (not necessarily the share) of their trade with the grouping does not fall, as demonstrated by Kemp, M. and H. Wan, 1976, "An Elementary Proposition Concerning the Formation of a Customs Union", in *Journal of International Economics*.

40. On the one hand, compared to the large number of participants in multilateral trade negotiations (over 120 countries, of which only the 15 countries of the European Union "speak with one voice"), a small number of blocs engaging in inter-bloc negotiations would tend to make co-operative solutions more likely; this supports the hypothesis that regional groupings work in favour of a more open world trading system. But it is equally true that the ability of players within blocs to fare well if inter-bloc bargaining fails tends to make co-operative solutions less likely, which supports the hypothesis that regional groupings tend to work against a more open world trading system. Both effects are at work.

41. See Olson, M., 1982, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, Yale University Press, New Haven. See also Oman, C., *Globalisation and Regionalisation*, *op. cit.*

42. This observation also points up the importance of negotiations for a multilateral agreement on investment rules, recently launched at the OECD, to be completed by 1997.

43. Cf. Stopford, J., 1992, *Offensive and Defensive Responses by European Multinationals to a World of Trade Blocs*, OECD Development Centre, Technical Paper No. 64, Paris.

44. Examples include a number of "growth triangles" in Asia, mentioned below, as well as several dynamic growth poles that straddle national borders in Europe, and along the US-Mexican and US-Canadian borders.

45. See Lawrence, R., 1991, *Scenarios for the World Trading System and their Implications for Developing Countries*, OECD Development Centre, Technical Paper No. 47, Paris. See also Lawrence, R., A. Bressand and T. Ito, forthcoming, *A Vision for the World Economy*, The Brookings Institution, Washington D.C.

46. Whereas real US wages doubled on average every 35 years between the 1870s and the 1970s, meaning that each generation lived twice as well as its predecessor, average hourly earnings of production workers measured in 1982 dollars *declined* from $8.55 in 1973 to $7.40 in 1994 (a level reached in the mid-1960s). Broader measures of workers' compensation which include supervisory workers and fringe benefits still show a growth of only about 9 per cent for the entire period, as compared to productivity growth of 24 per cent. Cf. Lawrence, R., *Single World, Divided Nations?, op. cit.*

47. Cf. OECD, 1994, *The OECD Jobs Study*, Paris.

48. Some of these points are developed in *ibid.*

49. On the importance of promoting industrial clusters, see also Porter, M., 1990, *The Competitiveness of Nations*, MacMillan, London; and Best, M., 1990, *The New Competition*, Harvard University Press.

50. See Lawrence, R. *et al.*, *op. cit.*

51. Countries that open their financial markets can benefit from capital inflows, but must also deal with the risks of a surge in financial flows (inward, which may drive up the exchange rate and undermine export competitiveness, as well as outward, as in the recent peso crisis).

52. See also Lawrence, R., *Single World, Divided Nations?*, *op. cit.*

53. Motta Veiga, P., *op. cit.*, demonstrates this in some detail for Brazil. Others have pointed out that while Chinese enterprises, in Chinese Taipei, Hong Kong, Southeast Asia or elsewhere (i.e. the "overseas" Chinese business community) and in China as well, tend to have a number of taylorist-like traits, e.g. all important decisions are taken at the top, they tend to specialise in one product, and labour relations tend to be marked by paternalism and low workforce loyalty, Chinese firms also tend to be integrated into a dense network of inter-firm relations based on extended kinship ties that provide through external economies what taylorist firms are forced to organise at considerable cost. What is important for determining the competitive strength of a Chinese firm tends less to be the size of the firm than the size of the network to which it belongs; this provides flexibility, and what grows is the network. Chinese firms often combine, in other words, elements of taylorist production with elements of flexible production, especially of the network enterprise (see, for example, Meyer-Stamer, J., "Micro-Level Innovations and Competitiveness", in Humphrey *et al.*, *op.cit.).*

54. Cf. Stopford, J. and S. Strange, 1992, *Rival States, Rival Firms*, Cambridge University Press, New York.

Other Titles in the Series

Adjustment and Equity (No. 1)
by Christian Morrisson (January 1992)

Managing the Environment in Developing Countries (No. 2)
by David O'Connor and David Turnham (January 1992)

Privatisation in Developing Countries: Reflections on a Panacea (No. 3)
by Olivier Bouin (April 1992)

Towards Capital Account Convertibility (No. 4)
by Bernhard Fischer and Helmut Reisen (April 1992)

Trade Liberalisation: What's at Stake? (No. 5)
by Ian Goldin and Dominique van der Mensbrugghe (May 1992)

Towards Sustainable Development in Rural Africa (No. 6)
by David Turnham, with Leif E. Christoffersen and J. Thomas Hexner (January 1993)

Employment Creation and Development Strategy (No. 7)
by David Turnham (July 1993)

The Disarmament Dividend: Challenges for Development Policy (No. 8)
by Jean-Claude Berthélemy, Robert S. McNamara and Somnath Sen (April 1994)

Pension Fund Investment from Ageing to Emerging Markets (No. 9)
by Bernhard Fischer and Helmut Reisen (January 1995)

What Institutional Framework for the Informal Sector? (No. 10)
by Christian Morrisson (October 1995)