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GLOBALISATION OF INDUSTRIAL ACTIVITIES

(Joint Report by the Industry Committee and the Trade Committee)

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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REPORT TO MINISTERS

The OECD has carried out considerable work aimed at a better understanding of the globalisation of industry and its implications for national and international policies. This report summarises the main findings and identifies policy areas where changes and greater international co-operation are needed.

Summary

Globalisation of industry refers to an evolving pattern of cross-border activities of firms involving international investment, trade and collaboration for purposes of product development, production and sourcing, and marketing. These international activities enable firms to enter new markets, exploit their technological and organisational advantages, and reduce business costs and risks. Underlying the international expansion of firms, and in part driven by it, are technological advances, the liberalisation of markets and increased mobility of production factors.

These complex patterns of cross-border activities increasingly characterise the international economic system and distinguish it from the earlier predominance of arms-length trade in finished goods. National economies are becoming more closely integrated as firms spread their operations and assets across countries. This brings greater economic efficiencies and welfare, as well as more intense competition, greater need for adjustment and more demands on national and international policy. The current challenge for many countries -- in a situation of low economic growth and high unemployment -- is to ensure effective adjustment while minimising related international frictions, so that the potential welfare and efficiency gains from globalisation are attained.

Government policies influence in various ways the development of globalisation and the ways in which domestic economies react to the more competitive international environment. They include policies which facilitate globalisation, policy areas which need to be re-oriented, and areas where closer international co-operation may be required.

Globalisation is a powerful motor of world-wide economic growth. Policies which promote trade and investment liberalisation and non-discrimination are particularly important in facilitating globalisation. Trade and investment policies and related domestic policies must continue to strive for open and contestable markets which stimulate competition among firms. However, policies in many areas need to be better focused on strengthening the capacity of economies to deal with rapid change and growing competition. They include improving the business environment and infrastructure, upgrading the skills and adaptability of the work force, and

enhancing conditions for small firms. However, policy instruments which target "domestic" beneficiaries are less effective because globalisation has blurred the origin of goods and nationality of firms.

Globalisation heightens the need for closer co-operation among governments at the international level and increases the interlinkages between different policy domains. This applies particularly to areas such as R&D and technology policies, intellectual property protection, foreign investment policies and competition law and policies. In addition, differences among national systems, such as business practices and regulatory regimes, have increased potential to become sources of international frictions as a result of globalisation. Improved transparency and understanding of these differences, including their impacts on access to markets, is needed.

Characteristics and driving forces of globalisation

New trends and combinations of investment, trade and inter-firm collaboration are changing the patterns and scope of world business and expanding the presence and influence of foreign companies in national economies.

International direct investment. Direct investment flows grew dramatically in the 1980s, doubling as compared with GDP and trade, fuelled by liberalisation and international firm strategies. This has increased the role of transnational firms in the world economy, where the sales of goods and services by foreign affiliates are now one and a half times the value of world exports. Foreign affiliate activities remain low in Japan, are moderate in the United States, and highest in Europe, Canada and Australia. Foreign manufacturing affiliates tend to have higher labour productivity and greater investment and trade intensity than purely domestic firms. They also tend to be characterised by large firms employing advanced business methods in high technology industries, with their R&D and other strategic management functions often centralised in the home country.

International trade. Certain forms of trade have become especially significant in the context of globalisation. International sourcing (the purchase of intermediate inputs from foreign sources) has grown faster than domestic sourcing and now accounts for at least one-half of all imports by major countries. Intra-firm trade appears to have kept pace with total trade and to be growing rapidly for countries most recently engaged in foreign investment, while intra-industry trade has risen significantly in almost all OECD countries.

International inter-firm collaboration. Collaboration (joint ventures, non-equity agreements, minority participations) enables firms to undertake projects that exceed individual technical and financial resources, gain market access and overcome investment and regulatory impediments. The annual number of new collaboration agreements doubled during the 1980s and has been maintained at a high rate subsequently. Collaboration tends to involve large firms from Europe, the United States and Japan, and is concentrated in sectors such as electronics, aerospace, telecommunications, computers and automobiles.

The characteristics of globalisation are crucially shaped by firm, industry, and country differences. Large multinational enterprises are the main actors, although a growing number of smaller firms are engaged in cross-border activities. In manufacturing, globalisation involves mainly R&D-intensive and assembly industries while labour-intensive industries are less globalised. Finally, this phenomenon is still largely concentrated in the OECD area although the Dynamic Asian Economies and China are rapidly becoming involved, as are some countries in Latin America and Eastern Europe.

Globalisation is the result of firm strategies to exploit their competitive advantages at international level, locate in final markets, and take advantage of favourable production factors and infrastructures. Global strategies are shaped by three sets of factors:

- a) *Technology*. Communication and transport costs have fallen, reducing geographical constraints. Innovation time and product life cycles have shortened, and R&D and knowledge intensity have increased, necessitating rapid and world-wide exploitation of new products and technologies.
- b) *Economic factors*. These include the availability and cost of key production factors, growth in foreign economies, productivity differentials and fluctuations in exchange rates.
- c) *Government policies*. Many governments have liberalised foreign trade, capital movements and investment, and some have been promoting different types of formal regional integration arrangements.

There are public perceptions that globalisation has impacts on employment in certain sectors. The Employment/Unemployment Study suggested that the net employment effects of international trade on OECD countries have been relatively small and that international investment in non-OECD countries has also had minor impacts on employment. Overall, the study suggested that technical progress had been more important than globalisation in reducing demand for low-skilled labour.

Policy implications

Changes in international business create the need to examine and, possibly, re-orient government policy at national and international levels, to obtain the gains and address problems arising from globalisation. These include policies that facilitate globalisation, policy areas which may need to be re-oriented or which have reduced impacts, and areas for greater policy co-ordination.

Policies Facilitating Globalisation

International trade and investment liberalisation and non-discrimination are of foremost importance in facilitating the globalisation of industry. The parallel liberalisation of capital movements has further aided this process.

Despite the continuing shift towards liberalisation by most countries, further efforts are crucial to reduce trade and non-trade barriers to the international flow of goods and services. Such efforts should include consideration of ways to:

- Further liberalise international trade and investment in information, technology and related services;
- Reduce constraints on the participation of foreign affiliates in R&D and technology programmes sponsored by governments, taking into account the need to ensure that the right to non-discriminatory access does not lead to free-rider behaviour;
- Reduce remaining restrictions on inward investment and strengthen the application of national treatment principles.

Policy Impacts of Globalisation

Greater interdependence of economies suggests that some areas of domestic policy may need re-orienting to take into account the competitive challenges of globalisation and improve their efficacy.

Domestic policies requiring improved focus

Some policies which traditionally have a largely domestic orientation may require improved focus. They include:

Business environment. Globalisation points to the need for a business environment which promotes the competitiveness of firms. This includes business infrastructures (technology and business services), access to investment capital at reasonable cost, the efficient operations of financial markets, and supporting physical and services infrastructure.

Labour markets and skill formation. Greater availability of skilled labour, and expanded investment in education and training and in the local knowledge base are all crucial for strengthening the capacity of firms to confront competition and changing demand and to create new areas of growth.

Small firms. Globalisation produces both opportunities and challenges for small firms. Better information on foreign business opportunities and improved financing conditions may be needed to enable small firms to internationalise their operations. More general measures to encourage diffusion of best practice in management and technology, simplified regulations and other measures to lower financing costs also become important to enhance competitiveness.

Policy effectiveness reduced by globalisation

There are other policy areas whose relevance and effectiveness are reduced by globalisation. These include:

Industrial support policies. Support targeted to domestic firms or domestic production is even more difficult to devise and even less effective due to greater cross-border operations.

Trade policies. Underlying concepts on which certain trade policy instruments had traditionally rested, such as the origin of goods and the nationality of firms, are now more difficult to apply. This raises complex issues regarding the nationality of products and definition of local content.

Areas for greater international co-operation

There are a number of areas where greater international co-operation would be useful, without necessarily requiring close harmonisation of policies.

Structural differences between countries influence international business behaviour and performance, and access to national markets. Such differences in national systems and regulatory regimes arise, for example, with respect to taxation, financing, distribution, labour and the environment. Improved transparency and greater co-operation could help reduce international frictions stemming from these differences. Building on recent and ongoing work in OECD and elsewhere, consideration should be given to fostering greater co-operation in the following areas in particular:

R&D and technology development. Greater international co-operation in R&D and technology development programmes can help avoid unnecessary duplication and reduce costs, and ensure that benefits from R&D are more effectively captured. Intellectual property requires consistent approaches to coverage and protection, and better policy enforcement to encourage creation and wider diffusion of new technologies, products and services.

International direct investment. It is essential to continue work already being undertaken on investment liberalisation, freedom of capital movements and national treatment. At the same time greater transparency and discipline are needed to reduce the distortions and costs arising from competitive use of incentives at national and sub-national levels to attract foreign investment.

Competition law and policies. Despite the general pro-competitive implications of globalisation, competition policy enforcement is needed to prevent the creation of anti-competitive monopolies or dominant firms and to prevent collusive practices at global level. This suggests an increasing need for international co-operation in the enforcement of sound competition policies. Furthermore, concern has been expressed that there are private barriers to market access (with or without government involvement) that may be outside the scope of competition laws. Thus it may be useful to address market access concerns with concepts from different policy areas (industry, trade, investment as well as competition) and to explore the feasibility and desirability of integrating competition rules into a multilateral framework.