Christopher M. Dent

The European Economy

The Global Context

ROUTLEDGE

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The European Economy

The shape of the world economy is changing. Globalisation and regionalism have led to the development of powerful but interdependent economic blocs. Much economic potential has shifted from the Atlantic to the Pacific area. In view of this *The European Economy: The Global Context* argues that economists need a broader, worldwide base of information if these processes and their effect on Europe are to be fully understood. Topics discussed include:

- Europe's experience of the growing trend of regionalism
- the single market
- plans for economic union
- EU enlargement
- Europe's Triad rivals
- EU external trade and trade relations
- technology and innovation
- foreign direct investment
- human capital issues
- environmental issues

This fresh approach highlights the issues which will challenge European countries into the twenty-first century.

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Preface

The idea for this book has been primarily driven by a belief that most current student texts on the European economy have up to now adopted a somewhat introspective approach. In a world economy that is more and more characterised by its global as well as regional interdependence, such an approach could become increasingly untenable. Europe will continue to play an important part in the economic events and developments of the twenty-first century, being both a large constituent part of the world economy and highly integrated into it. The European Union is responsible for over a quarter of total world output and is the largest global trader and investor. Thus it has an enormous influence over the destiny of other countries and regions, especially where the links of interdependence are strongest. Conversely, external forces have played an ever more important part in the development of the European economy itself.

Hence, it has been the main aim of this book to contextualise the European economy within the frame of the growing internationalisation and globalisation of economic activity. In attempting to achieve this I have covered most of the established themes normally found in more conventional texts (e.g. core aspects of European integration and policy). Thus, a parallel aim has been to provide readers with the usual wide grasp of the issues that concern the 'internal' dimension of European economy as well as the 'external'. Indeed, it will be shown that current overlapping forces at work within the European and wider world economy mean that we cannot talk about one without considering the other. This text will therefore have strong appeal both to those studying or teaching conventional type courses on the European economy and to those with a more global orientation.

Chapter 1 explores the nature of the European challenge that lies ahead and introduces some of the key themes that run through the text. The next three chapters analyse the different processes of European integration while providing a global perspective on them. Theoretical, historical and global views on regional integration are covered in Chapter 2. The more advanced stages of European integration are the subject of Chapter 3, namely the single European market (SEM) and the EU's intended plans for economic and monetary union (EMU). On the theme of EU enlargement, Chapter 4 discusses the prospects for widening the EU and the associated ramifications for third countries and regions.

Chapters 5 to 8 consider the wider global context of the European economy. The tripolar or triadic structure of the world economy is the subject of Chapter 5 in which Europe's traditional and newly emergent rivals are examined in close detail. Chapter 6 makes an extensive study of the EU's external trade order. A theoretical and historical analysis of the internationalisation and globalisation is made in Chapter 7, providing a key reference for other chapters and introduction for the chapter that follows. The most dynamic aspect of globalisation—foreign direct investment (FDI)—is investigated in Chapter 8, paying particular attention to Europe's role as host and source of FDI.

In the book's last three chapters, generic topics have been chosen which relate to key challenges facing the European economy. Chapter 9 is concerned with those which lie in the field of technology and innovation, noting many of the fundamental changes to which European organisations have had to adapt. In addition, Europe's own technological performance over recent years is evaluated while also highlighting those high-tech sectors where it must develop a stronger competitive position. Four different aspects of the European economy's human dimension are considered in Chapter 10: unemployment and employment, education and training, the impact of demographic change and social policy issues. The environment is the theme of Chapter 11 in which the ultimate global challenge to Europe and, of course, to other countries and regions, is discussed.

Within most chapters, text boxes have been used to provide overviews of related themes and thus enhance the reader's understanding of the issues covered.

At this point, I would like to clarify certain terms of reference that run through the text. The 'Commission' refers to the European Commission of the European Communities to give it its full title, while 'the Community' has been deployed to signify the European Union, or EU, during its historic precursial guises (i.e. the EEC and EC). Some readers may be confused by the use of the EU as a term that is almost interchangeable with Europe itself. This at times appears out of convenience but also owing to the coalescent function served by the EU on behalf of the European continent. While, admittedly, the EU member states do not yet constitute even half of the European landmass, around 80 to 90 per cent of the European economy's GDP can be attributed to the EU. Moreover, this figure can be expected to rise with the possible accession of new countries into membership by the turn of the century.

Finally, I should like to thank a number of people for the support they have given me while writing this book. I owe a great deal to the staff of my university library, especially Alison and Helen, who have had to deal with a number of my obscure requests and time-consuming tasks. The same must also be said of Freda and Eric 'next door' at Hull's European Documentation Centre. Thanks too to my colleague Pam Barnes for her advice on certain aspects of Chapter 11. I am very much in gratitude to Anna Oakshot at the EBRD who performed the very kind task of faxing through parts of a document that proved key to Chapters 4 and 8. I would also like to extend my gratitude to the Routledge team: Alison Kirk, Kate Smith, Anne Owen and Mo James, and to the copy editor Penny Allport.

Of course, the rigours entailed in an endeavour of this nature are not entirely borne by the one who receives any of the recognition that is forthcoming. I would therefore like to thank my family for their love and support, and in particular my wife who, above all else, has had to cope with an inordinate share of the domestic division of labour over the past year or so.

Cottingham
March 1996

Abbreviations

ACP	Africa Caribbean Pacific
ADD	Anti-dumping duty
AFTA	ASEAN Free Trade Area
APEC	Asia-Pacific Economic Co-operation forum
ASEAN	Association of South-East Asian Nations
CAP	Common Agricultural Policy
CCP	Common Commercial Policy
CEC	Commission of the European Communities
CEDEFOP	Centre for the Development of Vocational Training
CEE	Central and Eastern Europe
CEFTA	Central European Free Trade Area
CET	Common external tariff
CFSP	Common Foreign and Security Policy
CIS	Commonwealth of Independent States
CMEA	Council for Mutual Economic Assistance
CP	Contracting party
CUSFTA	Canada-United States Free Trade Agreement
CVD	Countervailing duty
DG	Directorate-General (of the CEC)
EAEC	East Asian Economic Caucus
EAP	Environmental Action Programme
EBRD	European Bank for Reconstruction and Development
EC	European Community
ECB	European Central Bank
ECIP	European Community Investment Partners
ECSC	European Coal and Steel Community
ECU	European Currency Unit
EDF	European Development Fund
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Area
EIA	Environmental Impact Assessment
EIB	European Investment Bank

EMEA	Euro-Mediterranean Economic Area
EMI	European Monetary Institute
EMP	Euro-Med Partnership
EMS	European Monetary System
EMU	Economic and Monetary Union
EPRG	Ethnocentrism-Polycentrism-Regiocentrism-Geocentrism
EPU	Economic and Political Union
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ESF	European Social Fund
E&T	Education and Training
EU	European Union
EWC	European Works Council
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
FTA	Free Trade Area
FTAA	Free Trade Area of the Americas
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Co-operation Council
GDP	Gross domestic product
GNP	Gross national product
GPA	Government Procurement Agreement
GSP	Generalised System of Preferences
HEI	Higher Education Institution
IBRD	International Bank for Reconstruction and Development (World Bank)
IGC	Inter-Governmental Conference
ILO	International Labour Organisation
IMF	International Monetary Fund
ISC	International Scientific Co-operation
ITTO	International Tropical Timber Organisation
JESSI	Joint European Sub-micron Silicon Initiative
LDC	Less Developed Country
LLDC	Least Developed Country
M&A	Mergers and Acquisitions
MEA	Multilateral Environmental Agreement
MFA	Multi-Fibre Agreement
MFN	Most Favoured Nation
MITI	Ministry of Industry and International Trade
MNE	Multinational Enterprise
MPD	Modulated Preferential Duty
NAFTA	North American Free Trade Area
NCPI	New Commercial Policy Instrument
NIC	Newly Industrialising Country

NIDL	New International Division of Labour
NTA	New Trans-Atlantic Agenda
NTB	Non-tariff barrier
OCA	Optimum Currency Area
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
OLI	Ownership-Locational-Internalisation
OMA	Orderly marketing agreement
OPEC	Organisation of Petroleum Exporting Countries
PAFTA	Pacific Free Trade Area
QMV	Qualified majority voting
QRs	Quantitative Restrictions
R&D	Research and Development
RIA	Regional Integration Arrangement
RSE	Research scientists and engineers
SBCD	Second Banking Co-ordination Directive
SEA	Single European Act
SEM	Single European Market
S&T	Science and Technology
STD	Science and Technology for Development
TAD	Trans-Atlantic Declaration
TAFTA	Trans-Atlantic Free Trade Area
TENs	Trans-European Networks
TQM	Total quality management
TREMs	Trade-related environmental measures
TRIMs	Trade-related investment measures
TRIPs	Trade-related intellectual property rights
UN	United Nations
UNCED	United Nations Conference on the Environment and Development
UNCTAD	United Nations Conference on Trade and Development
US	United States
USTR	United States Trade Representative
VER	Voluntary export restraint
WTO	World Trade Organisation

1 Global and regional interdependence

The context of the European challenge

INTRODUCTION

In recent years, the world economy has experienced a series of fundamental changes that has recast the underlying relationships on which it functions. The two principal dynamic forces that have driven this change are regionalism and increasing tendencies towards globalisation. Regionalism involves nation-states forming closer integrational links between them to varying levels of sophistication. These have been mostly formalised through regional integration arrangements (RIAs) or have evolved 'naturally' or informally through a private sector led rise in intra-regional trade, investment and financial flows. Regional co-operation is seen by some as another strand of regionalism which can consist of measures to link up infrastructures, improve the management of common resources or have more overtly political objectives than economic ones.

Globalisation is more difficult to define but can be thought of as the highest form of internationalised economic activity. This has chiefly entailed a deepening and widening of corporate integration both within and between the operations of multinational enterprises (MNEs). Both these trends combined have produced an ever elaborate network of relationships that has simultaneously blurred the demarcations of national borders and the internationalised firm's true identity and origins. Consequently, these developments and continuing reactions to them have created an increasingly interdependent world economy.

Europe has been a major participant in these formative processes. The European Union (EU), which represents fifteen of some of the world's richest nations, is the most advanced RIA that has yet emerged. The EU has also made substantial endeavours both to assist the regional integration of other nations and develop its own inter-regional links with them. European MNEs are among the largest foreign traders and investors whose corporate presence has been well established in every global region. The size of the European market and progressive European integration has itself induced foreign multinationals to locate there in growing numbers.

In trying to comprehend the position of the European economy within the framework of global and regional interdependence an equally critical examination of its contextual features needs to be considered. These comprise of trends and developments that, in unison with regionalism and globalisation, have affected the structural characteristics of the world economy and the conventional wisdom on which new modes of economic activity have been predicated. Hence, they are also reflective of the fundamental changes that have been engendered by the two dynamic forces. Such features and the challenges that lie therein include:

- The triad structure of world economic superpowers: consisting of the EU, the USA and Japan which together still dominate world trade and investment flows and constitute the major poles of economic wealth. The gravitational pull of these powers has resulted in stronger regionalism, for example, EU enlargements, the North American Free Trade Agreement (NAFTA) and the Asia-Pacific Economic Co-operation (APEC) forum. The Europe-Japan/East Asia link in triadic relationships remains, though, by far the weakest.
- The rise of the 'new competition': a number of developing economies, most notably from East Asia, have acquired newly industrialising country (NIC) status in post-war years. For some time they have undermined the competitive advantage of many European producers in labour-intensive, low-tech industries. However, many NICs have now begun to compete in higher value-added sectors spurred on by regional developments, the enabling role played by globalisation and a more integral multilateral trading system.
- The advent of new techno-industrial paradigms: the growth industries of the future appear to rest on the core technology clusters that have formed around information technologies, biotechnologies and new material sciences. The microchip revolution has brought about radical changes to how industrial activity is organised and co-ordinated, both in the workplace and on a cross-border basis. A wider socio-economic impact is also associated with the emergence of the information society.
- The improved management of knowledge and human resources: as a consequence of the above, companies, governments and other organisations have had to adopt a new approach to managing knowledge and human resources. The imperative to develop effective capabilities in knowledge-intensive industries and other activities requires a higher priority to be given to education and training.
- Establishing more sustainable patterns of economic development: the planet has had to bear severe ecological pressures that have originated from an accumulation of environmental malpractices. Most current scientific studies suggest that new patterns of development are necessary to avert global ecological collapse. European and other industrial nations

have up to now been largely responsible for these pressures, though developing countries are becoming increasingly answerable on a global scale. This is particularly pronounced where past established patterns have been emulated and growth rates are high.

- The market-oriented pluralist democracy as the leading credible model of economic development: this has led from the large-scale retreat of communism, most notably in Central and Eastern Europe (CEE), and the general implementation of more market friendly policies and practices across countries of diverse economic backgrounds.

In this opening chapter, we shall examine the nature of the European response, both actual and potential, to these challenges. Owing to the coalescent function performed by the EU and its dominance of the European economy, it will take the centre stage of our analysis. We will show that heightening global and regional interdependence and their contextual features has revealed the greater necessity for both:

- improving competitiveness against traditional and new rivals;
- extending or creating collaborative relations with accordant regional or national partners.

Although tensions may arise in balancing these two objectives, we shall also demonstrate that the latter has taken on a primary strategic role in helping to secure the former while consolidating European interests in a broader sense. Thus, a major theme emphasised in our analysis will be the strategic determinants that continue to underlie those actions taken by European business leaders and policy-makers alike in their efforts to meet those challenges.

THE TWIN FORCES OF REGIONALISM AND GLOBALISATION

The growth of regionalism

The development of stronger regional links between proximate countries will, of course, engender a higher degree of interdependence between them. They have also lent to global interdependence where RIAs have nurtured collaborative relations with others. Even among those states which have recently acquired independent status a concurrent aspiration to be part of regionalist initiatives can be noted. For example, the Baltic states and Slovenia have all expressed a wish to join the new Central European Free Trade Area (CEFTA). Institutionalised regionalism between participating members is most likely to commence with the objective of installing a free trade area, whereby tariffs are eliminated between them but each country retains the ability to set its own tariff rates on external imports. These, however, are harmonised within a customs union with the introduction of a common external tariff. Common or internal markets and monetary unions are respectively more progressive forms of RIAs which commit members both to remove further impediments to factor movements and converge their sets of regulations, standards and policies.

The economic attraction of joining such an arrangement lies in the static and dynamic gains that are internally generated and shared. Generally speaking, these include the wider scope for efficiency gains, market opportunities and the acquisition of key strategic assets. Implementing a successful RIA will depend on accommodating its members' strengths and weaknesses. The presence of significant incompatibilities can lead to the arrangement having to embrace a 'variable geometry' approach whereby different integrational schedules and agendas are set within the group. As the 1990s have progressed, this has become more and more relevant and applicable to the EU's plans for future economic and monetary union (EMU).

The RIA is largely a post-war phenomenon and throughout this period Europe has provided the template for most other aspiring regional groupings. The inauguration of the single European market (SEM) programme, the devising of plans for EMU and the international stature of the EU have made it not only the predominant RIA in Europe but also within the world. Regional agreements have become very popular among nation-states, particularly in very recent years with 33 of the total 108 RIAs that have been notified to the General Agreement on Tariffs and Trade (GATT) Secretariat since 1948 being signed in the early 1990s (see Figure 2.4, p. 47).

While an RIA can be mainly understood in terms of an internally focused, organisational body of countries its external impact and dimension is of great consequence. This can be most clearly illustrated by briefly charting the progress of the EU since its conception in the 1950s. Even the earliest stages of regionalism could be interpreted as a strategic reaction to the shift in geo-political power that had relatively disadvantaged the international position of Western Europe. This shift was gradually redressed by combining a wider range of activities and attracting new members to its core. The urgency of completing market integration and to realise the benefits it afforded was further underlined by the rise of new sources of competition, first from Japan and later on from the NICs. Fears of the SEM programme creating a 'Fortress Europe' in which the market it created was guarded by high protectionist walls and access granted through reciprocity agreements were subsequently articulated by outsiders. As it transpired these fears have been largely unfounded, as we 'shall discuss in later chapters, although certain defensive mechanisms have been installed.

The most important global effect of RIAs concerns the breaking down of the world economy into separate and sometimes overlapping regional blocs and the implications conveyed for the multilateral trade order. Those analysts who are opposed to the proliferation of regional agreements argue that both sets of relations cannot co-exist owing to the inherent tensions that lie between them. This is based on the belief that regional groups tend to protect their own internally liberalised markets by deploying high tariffs against third country imports.

A corollary of this is replacement of rule-based international relations, upon which multilateralism depends to function effectively, with powerbased relations which ultimately endangers it. Moreover, welfare losses can arise through trade diversion (see Chapter 2) which would have been avoided if regional trade concessions were converted at a multilateral level. It is further argued that the stability of the world trade system is placed at greater risk by RIAs as they act as a safe haven to which its members tactically retreat when faith in multilateralism has been effectively undermined (Bhagwati 1990, 1992).

Conversely, the case for compatibility between formalised regionalism and multilateralism is founded on the notion that RIAs have provided the essential building blocks with which global free trade can be constructed (Lawrence 1991). However, this rests on the assumption that internal liberalisation is matched by equivalent actions in any external regimes. Expectations of such behaviour originate from the hypothesis that what is preached at home will be practised elsewhere. For instance, the liberal mindedness inculcated from the installation of the SEM programme is thought to have had a positive influence upon the Uruguay Round of GATT talks with which it coincided (Woolcock 1993). Where regional integration has been accomplished by the maintenance of liberal external regimes then this has been favourably termed 'open regionalism'. This objective has even been recently endorsed by the World Trade Organisation (WTO 1995).

The active participation of open-minded RIAs in multilateral negotiations can also simplify them by the fact that fewer contracting parties are now involved. This was shown at the Uruguay Round when the European Commission acted as the interlocutor on behalf of the EU member states. Some regional arrangements may have also introduced liberalisation measures in advance of those that are moderated at a multilateral level in the future. The convergence of the EU's policy rules on foreign investment and competition could provide the WTO with advantageous starting-points in these respective fields if competence is to be granted over them in the future.

The formation of regional agreements has surfaced in all global regions and only countries with the most autarkic inclinations have remained non-signatories to them (see Table 1.1). Their strength relies on the economic capability and relations that exist between member states, in addition to a common political will. Consequently, the most developed forms of regionalism and those that demonstrate the highest potential are located in relatively prosperous global regions. Hence, the triadic structure of the world economy and the regional links that have been built around it are seen by some as mutually reinforcing to each other.

Table 1.1 Major regional integration arrangements (actual and planned)

RIA	*Members*	*Main features*
European Union (EU)	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, UK.	Common market more or less complete by the end of 1992. Plans to establish EMU between at least some members by 1999 are still intact but have been beset by both political and economic circumspection. A future enlargement into central and eastern Europe has also been scheduled. Currently the world's largest trading bloc and unified market.
European Free Trade Area (EFTA)	Iceland, Liechtenstein, Norway, Switzerland.	Established in 1960 as a looser regional arrangement to the EU's precursor, EFTA has experienced a gradual haemorrhage of its members to the former. This has recently culminated in the accession of three of its largest members to the EU in 1995. The European Economic Area enables the EFTA states to participate in most aspects of the SEM programme.
North American Free Trade Agreement (NAFTA)	Canada, USA, Mexico.	Signed in 1993 with a commitment to inaugurate a free trade area within 15 years. Some policy convergence in areas such as foreign investment, public procurement, the environment and labour standards.
Free Trade Area of the Americas (FTAA)	34 countries from the American continent (Cuba not a member).	The December 1994 summit laid out draft plans to install a free trade area across the continent by 2005.
Mercosur	Argentina, Brazil, Paraguay, Uruguay.	The most significant regional agreement to have emerged in Latin America. First conceived in 1991 with the Southern Cone Common Market set up by 1995. This, though, is more approximate to a customs union with a near complete common external tariff and some macro-economic policy co-ordination.

Association of South East Asian Nations (ASEAN)	Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam.	Formed in 1967 but whose initial objectives were more political than economic. Since 1977 a preferential trade agreement has covered an increasing number of sectors. In 1995, the idea of creating a free trade area (AFTA) by 2003 was accepted.
Asia–Pacific Economic Co-operation forum (APEC)	ASEAN, Australia, Chile, China, Hong Kong, Japan, NAFTA, New Zealand, Papua New Guinea, South Korea, Taiwan.	First formed in 1989 but took until its 1993 summit to make any progress towards any reciprocated trade concessions of note. An ambitious future agenda was set at the 1994 summit with intentions to establish a gradualised free trade area by 2020. Raised doubt over such plans concern the diversity of member countries and a number of serious internal disputes that continue to persist.

In East Asia, where institutionalised regionalism has remained weak, a more informal path to regional integration has occurred through the dynamic expansion of its economy. North American countries currently participate in their own specific RIA and two other overlapping arrangements, thus raising the degree of complexity with respect to regional and global interdependence. The variable geometry that is also evident could be the cause of considerable inconsistencies, arising from potentially conflicting integrational policies and political-economic objectives.

The Pacific Free Trade Area envisaged by the APEC forum and the possibility of a future transatlantic counterpart would leave only the European-East Asian arrangement to complete a triadic framework of trade liberalisation. A scenario of this kind cannot be ruled out for the same reason that it cannot be held as credible. Future plans to establish deeper regional integrational links in all parts of the Triad are dependent on a series of imponderable factors. These become more significant both in relation to the ambitiousness of those plans and the long-range schedules that are trajected for them. The member states of the EU have recently encountered this with the Maastricht Treaty's programme for economic and monetary union.

Moves towards globalisation

For most of history the internationalisation of economic activity has been typified by the exporting and importing of products between countries. The post-war acceleration of trade intensified this trend; more importantly newer kinds of international exchange began to alter the complexion of the world economy and internationalisation itself. Foreign direct investment (FDI), whereby multinationals have sought to establish both control and ownership of assets that exist beyond the home country of origin, is the most notable of these. Indeed, this is what essentially defines an MNE. The dispersion of a company's operations across national borders has made it more difficult to determine its own nationality while also threading the links of global interdependence between countries by integrating them into the systems of international production.

In more recent times, this have been achieved through complex integration strategies where the firm has often resembled more a network than a hierarchy, facilitated by international subcontracting, licensing agreements, strategic alliances and other forms of corporate linkage. The integrity of the firm has remained simultaneously intact while it orchestrates these network relationships from a centralised or decentralised command structure.

The latter of these—international strategic alliances—entail firms collaborating together at differing levels of commitment in activities that are designed to render mutual benefits, and hence are orchestrated jointly. They are not a new phenomenon (Kindleberger 1988), but their increased frequency and centrality to the core strategies of many companies make them particularly relevant when understanding MNE behaviour. Multiple participants may be involved in such co-operative ventures from various locations and tend to arise in industries with high entry costs, scale economies and rapidly changing technologies. In many ways they reflect interdependent reactions to compete within oligopolistic market structures with the added significance of the international or global level at which they are pitched. Pressures to collaborate in order to compete are partially founded on the more risk averse strategy this composes.

The multinational enterprise is essentially the product of modern times. Revolutionary technological advances in communications, transport and production have enabled firms to co-ordinate and configurate their actions across different international locations, partly through being able to adapt to the prevailing factoral and market conditions encountered. The cost competitiveness of producing standardised products and the convergence of international consumption patterns have also proved lucrative. Moreover, expansion into a more global competitive environment has been made possible through the MNE's utilisation of certain advantages (Dunning 1983, 1988). These fall into three generic categories:

1 Ownership-specific: these may be derived from the company's size (e.g. economies of scale and scope) and the ownership of intangible assets (e.g. proprietary technologies, skills, knowledge).
2 Location-specific: examples can range from the ability to obtain inputs of a higher quality, lower price or general strategic value; conducive government policies and infrastructural factors; the spatial distribution of markets.

3 Internalisation: internalised transactions within the firm have at times proven more attractive than external market transactions for factor inputs, final products and technological exchange and transfer. The effective use of market power and differentiation policies further enables MNEs to internalise benefits and gives incentive to integrate production and service facilities internationally.

A successful exploitation of these advantages by multinational firms has incurred radical structural changes on the world economy, especially when the corporate strategies deployed have progressed past the 'stand alone' and 'simple integration' stages (see Figure 1.1 and Table 1.2). More 'complex integration' strategies have redefined the manner in which international production is managed and organised by 'turning their geographically dispersed affiliates and fragmented production systems into regionally or globally integrated production and distribution networks' (UN 1994a:138). As a result of this exploitation and the subsequent changes for which they have been responsible, the MNE has come to represent the predominant

Table 1.2 The strategies and structures of multinational enterprises

Strategy	*Intra-firm linkages*	*Foreign affiliate type*	*Degree of integration*	*Environment*
Stand-alone (e.g. multi-domestic).	Ownership, technology, finance; mostly uni-directional.	Miniature replica of the parent firm.	Weak.	Host country accessible to foreign direct investment; trade barriers; costly communications and transportation.
Simple integration (e.g. outsourcing).	Ownership, technology, markets, finance, other inputs; mostly bi-directional; subcontracting.	Rationalised producer of one or a few elements in the value chain.	Strong at some points of value chain, weak in others.	Open trade and FDI regimes, at least bilaterally; non-equity arrangements permissible.
Complex integration at the regional or global levels (e.g. networks).	All functions; mostly multi-directional.	Product or process specialist; functional specialisation.	Potentially strong throughout value chain.	Open trade, technology FDI and related regimes; use of advanced information technology; convergence in tastes, heightened competition, low communication and transportation costs.

Source: Adapted from UN 1994a:137

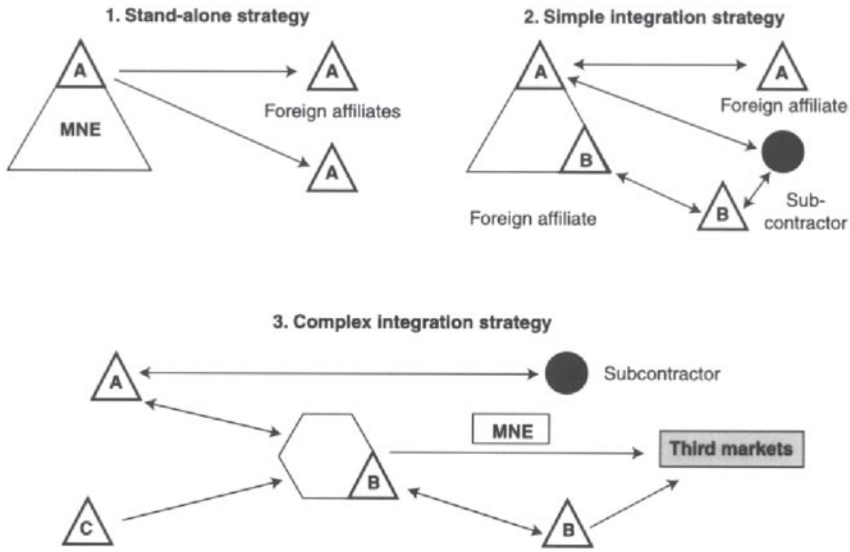

Figure 1.1 International production strategies
Source: UN 1994a:136. UNCTAD, Division on Transnational Corporations and Investment, *World Investment Report 1994, Transnational Corporations, Employment and the Workplace* (United Nations, Sales No. E. 94. II. A. 14) fig. I.1 and fig. II.2

form of corporate organisation. This is supported by the observation of a few simple facts. One estimate suggests that the top 500 MNEs account for nearly three-quarters of international trade and about half of world output. Around 40 per cent of international trade flows are thought to occur at the intra-firm level, that is trade between the divisions and subsidiaries of the same firm (OECD 1992a). Many multinationals have annual products that are proximate to some of the smaller developed nations.

It should, however, be noted that the global reach of most MNEs remains somewhat limited with most only active in a few countries while the operations of even the largest are still epitomised by their regionalised concentration (see Table 8.2, p. 269). The endurance of such trends undermines the notion of a globalised world economy, although the latter makes for greater interdependence at the regional level. However, an extrapolation of current general trends in international trade and FDI flows (over the last decade or so, FDI has grown four times faster than world output and three times that of international trade) together with the current evolutionary path of how international production is being organised provides, at minimal, the basis for a more complete globalisation of economic activity in the future.

Further support for this view has come from the recent surge of inward FDI flows to developing countries, particularly in the East Asian region, due to the growing locational and strategic attractions of a low cost base and future market prosperity. Foreign investments, together with international subcontracting and other collaborative ventures, have played a crucial part in integrating these countries into the world economic system.

A world economy in which a rising number of developing countries are reaching NIC status and simultaneously becoming more fully participative in moves towards globalisation has posed a series of challenges for the Triad powers. These challenges take different but strongly related forms. As the techno-industrial base of an NIC is upgraded so is its capability to compete more effectively in higher value-added sectors. In order to maintain their competitive position, firms from developed market economies are faced with a number of options.

To compete on the same cost and price terms is the most untenable option owing to the considerable comparative disadvantages now faced, for example on labour and certain other factor input costs. Where possible, a shift to value-added activities within the industry, or those related, which are at least a grade above those being entered by the NICs, would enable the firm to develop new, more unassailable competitive strengths. This would depend on both its technological and managerial capabilities as well as access to a better educated and trained labour force able to handle higher degrees of knowledge-intensive work. The combination of such a strategy with one whereby specific elements of the value-added chain are outsourced to NIC producers constitutes a deeper recognition of global interdependence. This may go deeper still if foreign investment is driven by strategic market motivations in addition to those of cost competitiveness. Intensified competition at home will naturally supply the extra provocation to follow this approach.

As this text will make clear in subsequent chapters, European companies have performed poorly in meeting many of these challenges. They have been relatively slow to take advantage of the investment opportunities that are being presented, especially in the more distant poles of new economic growth. Levels of new investment have even been disappointing with respect to those opportunities that exist closest to home, namely in the ‘transitional’ economies of Central and Eastern Europe. The response of certain sectors of European business to the threat of the ‘new competition’ from the NICs has also been criticised by those who highlight the restructuring still required more fully to adapt to global competitive realities. Furthermore, Europe maintains a competitive advantage in comparatively few high-tech, high-growth industries where the industrial battleground between the Triad economies will be the fiercest in decades to come. Thus, there are a number of fronts on which Europe needs to raise its level of endeavour to meet the challenge of global interdependence. We shall soon turn to those strategies that are being formulated with this intention in mind.

The interface between the twin forces

There are strong interconnections between regionalism and globalisation that cover a variety of issues and draw on similar motivational forces. Actions leading to the advancement of both can, at a general level, be interpreted as risk averse, strategic responses to counter apparent extraneous pressures while consolidating a more impregnable defence against them and any other future potential threats. These will include efforts to improve the efficiency, competitiveness and international stature of those parties involved and collaborative enterprises with compatible partners.

Such an approach is further to be expected in a world economy where global and regional interdependence both feed on themselves and each other. A policy of risk aversion pursued through collaboration or diversification is made more critical by the increasing number of permutations arising from greater degrees of interdependency existing between affected parties. This can be shown by the convoluted network of international strategic alliances which has evolved, especially in high-tech industries, and the overlapping regional agreements entered into by countries which can induce similar complex outcomes. The process is self-perpetuating as efforts to collaborate and diversify as part of both defensive and offensive strategies only serve to generate more permutations faced by all parties.

Extra complications are added by the mutually reinforcing effects that regionalism and globalisation can have on one another. In the last twenty-five years, world trade has risen by a factor of twelve, but trade among regional groups increased by a factor of seventeen, largely due to the stimulus given by market integration processes. Hence, internationalised firms will seek more extensive access to these markets through exporting or targeted FDI. The erection of protectionist walls by regional members around their markets will only award more incentive to seek an 'insider' position through inward foreign investments. Motives to develop a position of this kind are heightened by the dynamic efficiencies that are conferred by regional integration. These may be used to the benefit of the company in that regional market or in another if the cost efficiencies acquired can be put to purpose elsewhere. The marked acceleration of Japanese inward FDI to Europe, which coincided with the implementation of the SEM programme, and the huge inflows of US investment that preceded earlier stages of European integration have been strongly associated here. Strong evidence suggests that a positive relationship exists betWeen regional integration and FDI inflows.

An acknowledgement of this has partially motivated countries regionally to integrate. In most circumstances, inward foreign investment is generally accepted to have a significant beneficial effect upon the host economy through accompanying technology transfers, the implementation and diffusion of superior management and production techniques, employment growth and the injection of new capital. Regionalised efforts to attract third country multinationals have also entailed the use of supporting measures and policies, for instance tax allowances and a more simplified regulatory environment for business. However, the foreign operations of MNEs are also frequently subject to various constraints that either aim to check any potential abuse of their market power or extract optimum benefits from their activities (e.g. rules on local content). While these are still mainly administered at a national level, many of the major RIAs have made recent moves towards their regionalised harmonisation. This has largely been accomplished through the establishment of investment codes that themselves may be soon negotiated at a multilateral level.

Given the existence of a more open and interdependent global competitive environment, the view that neighbouring countries need to work together mutually to improve their competitiveness has been increasingly subscribed to. This has supplied a prime economic motivation behind the SEM programme and its core objectives. It may, therefore, seem ironic that such closer regional integration may benefit third country producers either directly if they have acquired 'insider' status through foreign investments, or indirectly through the growth-induced demand for imports. This must be balanced by the improved competitive position of the regional members both in their own collective market and those outside it. Globalisation makes it more and more difficult, though, to disaggregate the economic activities of producers with domestic origins from those that are foreign. Hence, regional integration can only generate potential gains for the combined community of enterprises that functions within its own borders. Attempts may be made in certain strategic sectors to close off the participation of external producers in specific areas, such as the EU's ESPRIT programme on information technologies. Global interdependence has made this approach a more arduous task which, in the case of ESPRIT, was clearly illustrated by the international strategic alliance that Siemens (a key participant in the project) had formed with IBM and Toshiba in the early 1990s.

We have already mentioned that national and harmonised regional policies have been adapted to meet the challenges posed by globalisation. There has also been the need for policy convergence between regional and national powers as economic activities have become more globally dispersed. This has already been well established in the field of trade policy under the auspices of the GATT and now the WTO multilateral framework. Other newer policy areas that have become more relevant include those on competition and foreign investment. As trade barriers have been successively removed and markets more comprehensively integrated so have the remaining domestic level impediments to international competition and cross-border investments been made more transparent. The low import and inward investment penetration made by foreign companies into Japan has been attributed to such impediments that have been termed as 'structural' in nature.

Multinationals that have developed a dominant market position straddling more than one regional market present a prima facie case for cooperation on competition policy between the authoritative powers involved. This recently occurred with the respective Trans-Atlantic authorities over the Microsoft case of 1994.

Similarly, MNEs require a degree of commonality to be applied on competition and investment rules for the sake of consistency and predictability. This may also apply to other policy fields, for example on environmental protection and labour standards. A further obligation that rests with governments to converge on policy relates to how companies will seek to exploit certain inconsistencies that advantage them to the detriment of either the host country or those that are indirectly affected. Convergence would to some extent help avoid power-based inter-regional or international relations developing in the future by its provision of a firmer rulebased framework. Parts of this are already in place or soon will be. Since the 1980s, the OECD Secretariat has supplied non-mandatory codes of conduct on competition and foreign investment policy at a plurilateral level. The WTO should serve in a stronger multilateral function for these to be negotiated in forthcoming years. However, a plurilateral approach between the developed countries of the OECD group may prove more appropriate as many developing countries would be unable to bear specific burdens which compliance would incur.

Finally, global networking at an inter-regional as well as a corporate level could well become a main feature of a globally interdependent world economy. This is likely to arise in areas where mutual strategic advantage can be jointly advanced, for example, through scientific and technological cooperation. Motive may also come from the priority to form closer political and cultural ties between the regional groups involved or collaborate on solving commonly held or global problems; for instance, population ageing and environmental degradation.

THE EUROPEAN RESPONSE: IMPROVING COMPETITIVENESS AND PROMOTING COLLABORATION

We have already exposed many of the important challenges for the European economy in the interdependent world economy. Let us now consider the two broad and overlaying categories into which they fall, these being the need to improve European competitiveness and establish firmer collaborative relations with accordant regional and national partners. Frequently, the objective of meeting the challenges bound in one category has been congruent with realising those in the other. This has particularly applied where inter-regional or third country co-operation has both enabled European business to strengthen the competitive position and, together with policy-makers, exert considerable influence over any ensuing rule-based structures designed to govern the new global economy. Thus, Eur-opean responses to global and regional interdependence have taken on a distinct strategic dimension when meeting both types of challenge.

Improving European competitiveness

Despite the post-war technological and industrial advances that helped reassert the European economy's status in the world, by the 1980s the term 'Eurosclerosis' had come to denote a cumulative inertness displayed in a wide range of its sectors and a general lack of dynamic growth potential. These were symptomatic of flagging European competitiveness and deep structural constraints that would continue to disadvantage European business if they persisted. Changes taking place within the new global competitive environment only served to amplify Europe's problems: the USA extended its dominance across many high-tech industries and international markets; the industrial prowess of Japanese producers continued to be demonstrated in a growing number of activities; in lower technology sectors the NICs were progressively strengthening their competitive advantage.

However, the revitalisation of the common market concept and the resulting SEM programme which embodied it has supplied some antidotal relief to Europe's failing condition. While deeper regional integration still lies at the centre of the EU's struggle to improve its competitiveness, other key initiatives have been required to act in a fortifying and complementary manner. These have mainly arisen in the fields of science and technology, human capital development, various forms of industrial policy and measures aimed at enhancing social as well as economic cohesion across the Union.

The beginnings of a more coherent approach to improving European competitiveness that also made fuller acknowledgement of global and regional interdependence came in the form of a 1990 Commission study document (CEC 1990a). Its main aim was clearly to establish the division of responsibilities between business and public authorities in creating a dynamic environment favourable for industrial development. Furthermore, it called for a marked departure from the defensive, protectionist sectoral approaches that had been previously adhered to. According to the Commission, this made it possible to: accept the realities of global interdependence; highlight the problem of different national approaches to similar problems; devise a more modern approach on industrial policy.

This was followed in June 1993 by the European Council asking the Commission to prepare a broad-ranging policy position culminating in a White Paper that set out a medium-term development strategy for growth, competitiveness and employment. The White Paper was presented a few months later in December (CEC 1993a) and has since provided the main analytical focus on the structural problems confronting the European economy as well as a framework of measures aimed at resolving them. With

Box 1.1 Gauging an economy's competitiveness

Attempts to measure the competitive position of an economy relative to others is a complex task, made even more so by the processes of globalisation and regionalism. The OECD's (1992d:242) own definition of national competitiveness describes it as the ability to "meet the test of international markets while simultaneously maintaining and expanding the real incomes of its citizens". Traditionally, competitiveness has been expressed in either microeconomic or macroeconomic terms.

The microeconomic or firm level approach comprises of an examination of product price, quality, design, technological content, after-sales service and the extent to which these aspects are being commercially exploited. Comparative profitability and debt levels, foreign and domestic market shares in internationalised markets and other indicators can be used to gauge competitiveness. An evaluation of more dynamic processes may include the effective exploitation of economies of scale and scope, the installation of new flexible production techniques and the relative product lead times (i.e. the time taken to develop and produce new products). Measuring macroeconomic competitiveness requires a consideration of general price and unit costs levels throughout the economy, its exchange and interest rates and the relative stability of the macroeconomic environment.

The firm's competitive capabilities are partly determined by its own interaction with those capabilities which are predisposed within national or regional systems (Ostry 1990). This not only refers to those shaped by macroeconomic conditions but a miscellaneous range of structural features found within the economy. These in themselves may be quite unique and unable to be replicated elsewhere, or may arise through a combination of factors that are mutually reinforcing (see Porter 1990). Such features can be infrastructural, cultural, economic, institutional or technological in nature. Consequently, efforts to define an economy's 'structural' competitiveness have been more highly prioritised in recent times.

the assistance of this document, we shall mainly examine the issue of European competitiveness.

In its opening pages, the Paper insisted that there was no miracle cure nor were reversion to protectionism, a dash for economic liberalisation, drastic cuts in labour costs and social provisions to form any part of strategies to be implemented. This paid respect to the conventional wisdom underpinning the 1990 study document, while alluding that Europe's 'social market' model was not to be ditched in favour of another (e.g. the US's 'free market' counterpart) but rather re-engineered. Growth, competitiveness and employment were perceived as mutually reinforcing economic objectives. The latter of these was given especial relevance by the fact that the White Paper's overarching objective was the creation of fifteen million new European jobs by the end of the decade.

Employment growth was seen as a key component in any future competitiveness strategy while simultaneously ensuring that economic and social progress went hand in hand, in keeping with the social market model. Recent European performance on employment growth had been comparatively poor. By 1994, this was reflected by an EU unemployment rate of 11.2 per cent that was nearly twice that for the USA (6.1 per cent) and around four times greater than Japan's rate of 2.9 per cent (see Figure 1.2). A reversion of these trends was necessary to reduce the considerable drag factor that high rates of unemployment were placing on European competitiveness. Not only did this situation represent a significant loss to current and potential growth but also the incurrence of large public and social costs on the European economy. Moreover, the issue of how Europe manages its human resources lay at the centre of other related challenges. Forthcoming demographic changes, most notably population ageing, add further imperative for more flexible forms of work organisation to be introduced and a reexamination of social policy. Technological change and the rise of the new competition require a European workforce that is adept with more knowledge-intensive forms of industrial activity. This too carries important implications for the way in which education and training systems are resourced and organised. Improving the employability of European labour was thus crucial, particularly in the new growth industries of the next century.

To achieve these ends and generally enhance the EU's competitive position in the world economy, the White Paper drew together a combination of measures, the vast majority of which were to be implemented at member state level. The proposals were largely non-binding, although their main objectives were accepted as strategically critical if not somewhat ambitious in some cases. In broad terms, these measures were covered under the following themes:

- New patterns of practice in labour markets and the management of human resources: the implementation of more flexible work arrangements through the removal or adjustment of regulations causing labour market rigidities, less passive and more active labour market policies (e.g. training) and the promotion of other initiatives conducive to creating employment. The reduction of non-wage labour costs (target amount of 1–2 per cent of GDP equivalent) and greater moderation in wage payments, particularly in labour-intensive industries, to help stimulate employment growth. A stronger emphasis placed on human capital investment and lifelong learning.
- Large scale infrastructure projects: to help to optimise the benefits of regional integration and ensure greater economic and social cohesion in the EU. These were primarily aimed at accelerating the establishment of Trans-European Networks (TENs) in transport, energy and

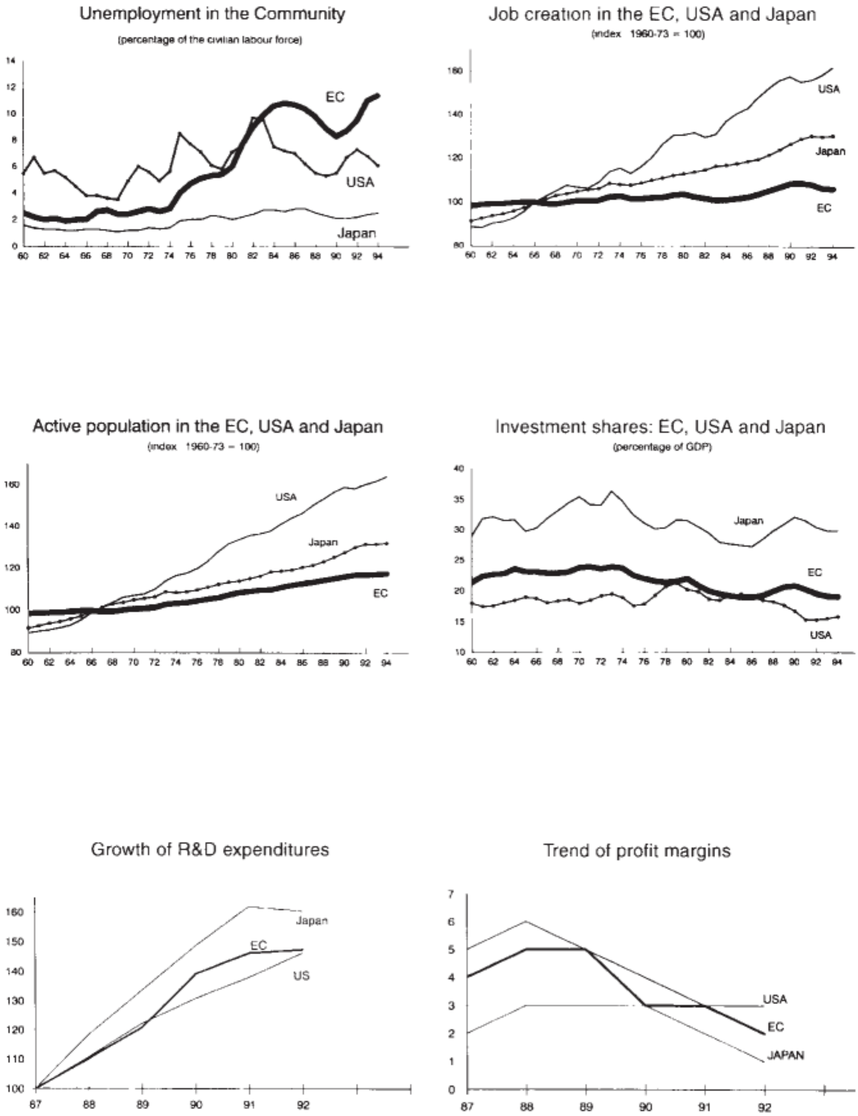

Figure 1.2 Competitiveness indicators: Europe and the Triad
Source: Compilation of evidence from GCE White Paper, CEC 1993a

communications that relied on a mobilisation of funds that nearly amounted to ECU 400bn up to the year 2000. In addition to these were environmental projects valued at a total ECU 174bn over a similar period that were intended as part of a new 'sustainable' development paradigm. Finance for these measures was to be raised mainly at member state level through both private and public capital, with the EU

committing structural funds and new 'Union Bonds' (subsequently withdrawn) in support.
- More balanced and co-ordinated macroeconomic policies across the EU: this was essential to restore the confidence and stability in the European economy. Moves towards the convergence criteria of EMU on public finances, exchange rates and interest rates were seen to provide favourable macroeconomic conditions for growth, competitiveness and employment.

Links between what had to be achieved internally to unlock Europe's competitive abilities and their external ramifications were made with an acknowledgement of the further globalisation of markets and economies. Chapter 2A of the White Paper stated that this had made it 'no longer possible to divide industry and geographical areas into clearly identified and relatively independent segments' (71), and hence the solutions proposed to improve European competitiveness had to be adapted to consider this. For example, it suggested a flexible approach to be adopted on international strategic alliances: the creation of welfare reducing oligopolistic situations were to be avoided, whereas a different view was taken if they are able to counterbalance the power of their US and Japanese competitors.

Additional guidelines proposed for a policy of global competitiveness included exploiting the competitive advantages associated with a gradual shift towards a knowledge-based society, promoting a sustainable path of industrial development and reducing time-lags between the pace and change in supply and the corresponding adjustments in demand. The measures suggested within these guidelines served only as a frame of reference from which future business and policy initiatives could take their cue (see Table 1.3). Apart from the gains yet to be had from completing the SEM, the role of TENs and the need to accommodate new technological realities in future economic activity, the designated section on 'competitiveness' within the White Paper also stressed the importance of maintaining an open economy and the EU being perceived as a reliable global partner.

Once past the opening moral rhetoric concerning the need to integrate better the developing countries into the world economy and extend and deepen multilateral processes, more revealing motives are bared. The developing and transitional countries on the EU's southern and eastern peripheral regions are particularly targeted for assistance, with the CEE economies providing a future low cost techno-industrial base to be exploited within Europe. The NICs of East Asia and Latin America are chosen for the new regional market opportunities they present and a means by which European competitiveness can be further sponsored. According to the White Paper, the building of robust multilateral frameworks should be accompanied by more harmonious and enforceable rule structures. This suits the EU's strategic interests in that it is well positioned to exert strong influence over these. Moreover, this could potentially lead to the EU pushing

Table 1.3 Guidelines for a policy of global competitiveness

Objectives	*Means*
1 Helping European firms to adapt to the new globalised and interdependent competitive situation	● capitalising on the Community's industrial strengths; ● developing an active policy of industrial cooperation; ● establishing a concerted approach to strategic alliances; ● targeting measures to ensure the competitive functioning of markets.
2 Exploiting the competitive advantages associated with the gradual shift to a knowledge-based economy	● reforming tax policies so as not to create employment disincentives and to promote incentives for the efficient use of scarce resources; ● developing a policy to encourage 'non-physical' investment (training, research, technical assistance); ● bolstering policies to streamline and rationalise rules and regulations; ● reviewing the criteria governing the use of public instruments in support of industry so as to enhance their impact on the growth of value-added and employment; ● launching a European policy aimed at quality.
3 Promote a sustainable development of industry	● increase substantially and co-ordinate R&D efforts in the field of clean technology; ● develop economic incentives to support the diffusion of R&D results into products and processes.
4 Reducing the time-lag between the pace of change in supply and the corresponding adjustments in demand	**Demand-side measures**: ● pursuing initiatives aimed at facilitating a concerted revival in consumption at world level; ● promoting the emergence of new markets. **Supply-side measures**: ● encouraging continuing structural adjustment by supporting privatisations; ● underpinning the dynamism of SMEs. **Measures to improve the relationship between supply and demand**: ● facilitating partnerships between large firms and their subcontractors; ● improving the interfaces between producers and users; ● establishing collaboration networks so as to develop clusters of competitive activities.

Source: GCE White Paper, CEC 1993a:81

for rules that aim to create a more level playing field between itself and its competitors that systematically advantages European business. The possibility of such multilateral rules being implemented in the future may be vindicated on the basis of social or environmental 'righteousness', as recently shown by arrangements within NAFTA and new trade clauses to be introduced into the EU's own Generalised System of Preferences (GSP) scheme by 1998.

However, more overt strategic uses of trade or any other policy have been increasingly seen within the EU as undesirable. Nevertheless, even the most liberal minded member states have defended a coercive approach both to maintain the multilateral rules they have helped to forge and against those third countries found guilty of conducting illicit commercial practices. Put another way, 'fair' competition must prevail, though this relies on an objective interpretation of what exactly is fair and what is not. More importantly, an individual economy's ability to meet the challenges posed by a more globalised world economy is to a large extent dependent on its own relative openness regarding its policy and regulatory frameworks. Without it, the economy may lack the capacity to participate effectively in the integration strategies of multinationals and attain the recipient benefits that are conferred by doing so.

As part of its final analysis on improving competitiveness, the White Paper contended that European policy frameworks needed to converge more where appropriate while also displaying more sensitivity to the imperatives of global and regional interdependence. This was necessary to remove the structural distortions within the European economy that still hinder its progress on several fronts. Although adherence to the plans for EMU in Europe will obviously produce a considerable degree of macro-economic policy convergence between member states, an asymmetric pattern still typifies many microeconomic policies pursued across the EU. What approach to adopt is dependent on a number of considerations.

Convergence can lead to joint actions which produce synergetic gains, avoid duplication of effort and serve mutually to enhance the competitiveness of active partners. This has been clearly illustrated in science and technology (S&T) collaborations and other forms of industrial co-operation. It can also entail the common compliance to a particular policy that is known to yield an assortment of economic benefits, such as shifting the tax burden from labour and capital on to environmental malpractices. Certain policy fields will, though, require some autonomy in order to retain the flexibility needed to respond to unique localised conditions and structures. Such requirements are supposed to be safeguarded by the subsidiarity principle which, through proper application, can also have a positive impact on European competitiveness. The suitability of deploying convergent policy strategies can thus vary in terms of what convergence entails and its actual relevance to the policy field in question.

Nonetheless, the Commission has generally urged member states to adopt a more common approach on similarly shared problems in subsequent communications that have led from the White Paper on Growth, Competitiveness and Employment (e.g. CEC 1994a, 1995a). This has been supported by mechanisms that have been installed at EU level to facilitate the exchange of information, experience and best practice between relevant agents. At both a member state and EU level, the recasting of policy to befit an increasingly globally and regionally interdependent world economy has mainly involved recourse to measures conducive towards inward investment and export promotion, the extending of influence over governing international rules and the building of collaborative links with other national and regional powers. The last of these aspects has particularly acquired special significance in recent years owing to their accelerated proliferation and strategically important nature.

Establishing firmer inter-regional and third country collaborative relations

Since its conception, the external relations of the EU have been mainly determined or influenced by its external trade policy, or Common Commercial Policy (CCP). This itself has been shaped into a pyramidal structure of preferential trade relations in which countries on the EU's external periphery are placed at its apex. Triadic trade matters have been largely resolved through GATT rounds and a series of bilateral negotiations that have lately become set within more resolute frameworks. Relations with more distant developing countries are mostly settled through the Lomé Conventions, for the Africa Caribbean Pacific (ACP) ex-colonial states, and the GSP scheme.

However, in more recent times, the EU has sought to broaden the scope of its external relations. This has primarily entailed a widespread introduction of collaborative initiatives on an inter-regional basis or with third countries usually contained within 'useful bilateral economic packages' of measures (CEC 1995b). Another related trend has been the greater emphasis placed on inter-regional trade relations which have often formed part of the collaborative agreement signed. While this development has been reactive to global and regional interdependence, the motivation behind it has not been purely economic.

Closer political ties have been achieved between the EU and other powers through such arrangements. In some cases, joint actions to overcome specific related problems have been the focus of co-operation, such as the special 'drugs' provisions in relations with the Andean Pact countries. The rich nations which form the EU are also under a moral obligation to extend numerous forms of assistance to the poorer developing countries in particular. Global or regionalised environmental degradation has also compelled the EU's member states to help co-ordinate international solutions to them.

Economic feedback effects from such collaborations have nevertheless been positive from the benefits conferred by the further extension of Europe's geopolitical influence and greater degrees of global and regional stability that are attained. Networking the EU's inter-regional and third country collaborative ventures has, though, been driven principally by strong economic motives that must be understood in the context of global and regional interdependence. Nearest to home, these have been formalised through the Europe Agreements that have been signed with six of the CEE states, while the recent inauguration of the Euro-Med Partnership has established a new pattern of co-operation with those nations on the EU's southern periphery. The existence of close cultural and historic ties combined with the considerable economic potential of the CEE states, both as a market and production base, has spurred the EU particularly to prioritise reintegration into the world economy. Up to now, this has been primarily achieved by first integrating back into the core European economy.

Further afield, the EU has taken a strong interest in assisting the regional integration that has been undertaken by non-European countries (CEC 1995c). The reasons for this are numerous. Its encouragement is likely to lead to a growth-induced increase in import demand and enable foreign investors better to rationalise production and distribution networks in the region. These benefits will be additionally forthcoming for European firms by the technical, financial and other forms of assistance being granted by the inter-regional agreement. The links consolidated by these actions could make the partner region more economically dependent on the EU in certain respects, for example, in a technological sense. While this is to be avoided it may not be possible, especially for developing countries. Meanwhile, European producers may find themselves in a position to exploit relatively captured markets as an outcome. Integration at the corporate level could also prove beneficial. From the late 1980s onwards, the European Community Investment Partnership (ECIP) scheme has attempted to provide the advantageous conditions under which these links can prosper.

Inter-regional collaboration may also enable the stronger party to fashion the structure of its partner's trade so as to lead to a consequential improvement in its own balance. Such gains involved may be mutual, although any resultant trade diversion will have a negative impact on third countries and global welfare levels. The EU's collaborations with developing countries, whether they form part of a negotiable regional group or not, have often comprised of measures to promote their compliance to established multilateral rules. Where it has been able to exert significant influence over their formation, the EU has obviously been especially eager to assert.

The EU has signed a growing number of inter-regional agreements in recent years. These include those with Mercosur, the Andean Pact and CARICOM in Latin America, ASEAN in East Asia and the Gulf Cooperation Council (GCC) in the Middle East (see Table 2.4 on page 58). While the relatively limited extent of collaboration within these agreements has admittedly denied them of current global significance, the network links which have been instituted may soon prove their future worth. This will depend on the strategic importance of the EU's partner regions and the degree to which regionalism will shape the contours of global economic relations. In a scenario where RIAs become more the norm, inter-regional agreements can also be expected to flourish. They may be encouraged by the broad opportunities they offer to improve mutual economic security in an ever uncertain and interdependent world economy.

As might be expected, collaborations have tended to be of a higher order between the EU and its Triad rivals. Co-operation in the fields of finance, macroeconomic policy, science and technology, education and a range of others is well developed, especially those of a Trans-Atlantic nature. However, in areas distinguished by their strategic sensitivity, collaboration has been either restrained or not permitted. One frequently cited example of the latter has been the US's Sematech semi-conductor programme. Perhaps the more important issues have centred on how the Triad powers have sought to establish sets of rules to be abided by between themselves and those designed at a plurilateral or multilateral level (Winters 1993).

With the increased globalisation of markets and economies has come the need to implement new rules and converged policies in order to maintain an effective state of governance over cross-border activities. High ratios of Trans-Atlantic FDI and intra-firm trade flows have meant that a considerable degree of interdependence exists between the EU and US economies. The regulatory capabilities of both powers have enabled them to forge a more common approach in areas such as competition policy and rules on foreign investments with the assistance of organisational bodies like the Transatlantic Policy Network. This has led to greater interpenetration whereby each party has affected the laws of the other or displayed extra comity for them (CEC 1995d).

While Trans-Atlantic co-operation over such rule setting has not been without its frictions, the tone of triadic negotiations involving the Japanese has been markedly different. The adoption of a more coercive approach taken in most dialogues with Japan, particularly by the USA, has arisen owing to three main factors. First, Western reactions to the ascendant economic superpower have comprised of measures aimed to contain its direct and indirect impacts upon their own economies. These have mainly been targeted at reducing Japan's huge post-war trade surpluses. Second, the benefits of Japanese economic growth do not appear to have been distributed externally. The country's low import propensity and low ratio of inward FDI flows have been blamed on the existence of varied 'structural impediments', which accordingly have been a prime focus of more recent negotiations. As a consequence of both these factors, the other Triad members have frequently sought to exert considerable *gaiatsu* (foreign pressure) on Japan to make compensatory adjustments (Strange 1995). The inability of Japan to translate its international economic stature into its political equivalent forms a third factor, and has meant that the Japanese have found it difficult either to resist *gaiatsu* from both the EU and the USA or to influence the forming of global rules to the same effective degree; the ability to achieve the latter would assist its cause with the former. The Uruguay Round of

GATT clearly demonstrated the capability of the Trans-Atlantic powers more or less to determine both the parameters of multilateral negotiations and the main body of subsequent rules to emerge from them.

Bilateral collaborative agreements with certain distant third countries have proved useful to the EU where it has not been able to extend some form of control or support with respect to their development through multilateral mechanisms. This has especially applied to East Asian nations and, most recently and notably, China (CEC 1995e). The need to claim some form of participatory role in China's future development is crucial, given both the country's enormous economic potential and the range of unpredictable outcomes which depend on how and to what extent this potential is realised. This relates as much to global warming as it does to global trade and investment flows.

Formulating new collaborative relationships with the other dynamic Asian economies will also be necessary due to the growing importance of the Pacific region. The imminent 'graduation' of many of them from the EU's GSP scheme, the recent inauguration of the Commission's 'New Asia Strategy' and the first of many planned Asia-Europe Meetings (ASEM) held in March 1996 have already signalled Europe's intentions to establish a different and more substantial form of partnership. In a recent communication, the Commission admitted that 'reinforcing links with ASEAN…or with individual countries of the Asian region would also help to ensure that Asian regional integration occurs in a way compatible to EU interests', and that 'if the countries of East Asia were, as a result of regulatory cooperation within APEC, to align their regulatory systems practices to those of the United States, this would place the EU at a competitive disadvantage, at least to the extent that a large and dynamic part of the world economy developed as result of a system which diverged significantly from that of the Union' (CEC 1995b). Drawing closer ties with Asia could thus prove to be Europe's most critical challenge well into the next century.

CONCLUDING REMARKS

The advance of global and regional interdependence poses some strategically important challenges for Europe at various levels and in many fields of endeavour. The cursory glance we have made at the European economy and the geo-political position it currently occupies suggests that there is much work ahead if it is effectively to rise to meet such challenges. The increased globalisation of economic activity also means that it has sometimes become difficult to identify what actually is a constituent part of that economy, who exactly its agents are and to what purpose they are working. Thus, any study of it and the challenges to be confronted in the next century has to be set within the context outlined in this chapter. This also applies to those that subsequently follow.