



OECD DEVELOPMENT CENTRE

Working Paper No. 57
(Formerly Technical Paper No. 57)

CONFLICT OR INDIFFERENCE:
US MULTINATIONALS IN A WORLD
OF REGIONAL TRADING BLOCS

by

Louis T. Wells, Jr.

Research programme on:
Globalisation and Regionalisation



TABLE OF CONTENTS

Summary	9
Preface	11
INTRODUCTION	13
EVOLUTION OF STRATEGIES OF US MULTINATIONALS	16
GLOBAL STRATEGIES — THE 1980s AND 1990s	21
INVESTMENT AND REGIONAL TRADING BLOCS	31
REGIONAL TRADING BLOCS AS SOURCES OF ADVANTAGES	33
CONCLUSIONS	35
Notes and References	37
Tables	41

RÉSUMÉ

Les dirigeants des multinationales américaines manifestent une indifférence quasi générale face à la menace que représente pour le système mondial des échanges l'établissement de blocs protectionnistes régionaux.

Cette absence de crainte de la part de ces responsables n'est pas surprenante car leurs stratégies passées et celles plus récentes, que l'on qualifie souvent de "globales", étaient et sont, en réalité, largement basées sur des systèmes de production régionaux. Il s'avère que les bénéfices industriels et commerciaux réalisés à partir d'unités de production plus dispersées sont moins importants que les coûts d'exploitations de tels systèmes. C'est pourquoi la plupart des échanges industriels des multinationales américaines s'effectuent sur une base régionale et risquent d'être peu affectés par la création de blocs d'échanges régionaux.

Les stratégies de l'ensemble des multinationales ne seront menacées que si les blocs régionaux limitent les investissements étrangers. Cependant l'historique de ces groupes d'échanges régionaux montre que ce type de restriction est improbable. Par ailleurs, une limitation des investissements nuirait plus aux concurrents japonais qu'aux multinationales américaines qui ont déjà mis en place des unités de production, bénéficiant d'une valeur ajoutée substantielle, au sein de ces régions susceptibles de devenir des blocs d'échanges.

L'indifférence manifestée par les dirigeants ne signifie pas que la création de tels blocs soit bonne pour les intérêts nationaux mais on ne peut toutefois pas se fier aux dirigeants des multinationales américaines pour s'y opposer.

SUMMARY

Managers of US multinational corporations generally respond with a "big yawn" to warnings that the world trading system might evolve into a set of protectionist regional blocs.

Their lack of fear is justified, since both their past strategies and their more recent, supposedly global strategies have resulted principally in regional systems of production facilities. The gains from manufacturing and trading among more widely dispersed facilities seem lower than the costs of managing such a complex system. As a result, US multinationals' trade in manufactures stays mostly within the region of production, and would be little affected by the emergence of powerful trading blocs.

The strategies of most US multinationals would be threatened only if regional blocs restricted foreign investment. This seems unlikely, given the history of regional trade groups, and restrictions on new investment would probably harm Japanese competitors more than US multinationals, which have already established production facilities, with significant value added, inside potential trading blocs.

The managers' indifference does not mean that the emergence of such blocs would favour US interests, but it does mean that one cannot rely on managers of US multinationals to lead the opposition.

PREFACE

The Development Centre is carrying out a major research project on "Globalisation and Regionalisation" as part of its 1990-92 Work Programme. The project aims to provide a better understanding of the economic and political forces that are working for, and against, the formation of regional economic groupings in Europe, the Western Hemisphere and Pacific Asia, and how these forces interact with those (essentially microeconomic) that are driving globalisation. The purpose is to assess the implications for the strategies and policies of various categories of developing countries.

Managers of multinational corporations are often thought to be among the economic actors most directly concerned that regionalisation may degenerate into the formation of relatively closed regional trading blocs. They are also widely considered to be powerful political actors, capable of pushing national governments into lowering barriers to international trade. The globalisation of competition and the continuing difficulties in the Uruguay Round could reasonably be expected to lead corporate managers to exercise their considerable economic and political powers in defence of the global trading system and a successful conclusion to the current GATT negotiations.

This paper, which examines the attitude and behaviour of US manufacturing multinationals, finds that the issue of regionalisation is in fact met with a surprising degree of indifference by corporate managers. The main reason is that, contrary to what is often thought, production in most firms is regional, not global; and it is production, or sourcing policy, that counts when a manager evaluates the dangers of potential new barriers to inter-regional trade. Companies can (and many US multinationals do) follow global strategies in finance, product design, advertising and so on, without having to worry about restrictions on the movement of goods from one region to another.

The paper shows, for example, that over 90 per cent of US manufacturing multinationals' exports, from both their overseas subsidiaries and the United States, go to other countries in the region of the exporter. US manufacturing multinationals thus show considerably more interest in the lowering of intra-regional barriers to trade than they do in preventing new restrictions on inter-regional trade.

Restrictions on inter-regional investment are a completely different matter, and would represent a serious threat for US multinationals. Experience suggests, however, that regional economic integration tends to produce competition among countries to attract foreign firms — so that regional investment barriers tend to fall to

the lowest of those of the member countries — rather than co-operation among governments to exclude foreign investors.

None of this means that the US government, or other governments, should condone a retreat from global trade liberalisation in favour of regional trading blocs. Nor does it imply that such a movement is inevitable or even likely, or that it would be beneficial for global welfare. In pointing up and explaining US multinationals' remarkable indifference to regional blocs, however, this paper — written by a prominent US business scholar — makes an important contribution to the Centre's research on globalisation and regionalisation.

Louis Emmerij
President of the OECD Development Centre
March 1992

INTRODUCTION

Efforts to discuss with managers of US multinational firms the possible emergence of a trading system based on regional blocs are generally met with a "big yawn". This paper attempts to explain this rather surprising lack of concern. Given the recent emphasis on global strategies by multinational firms, one might expect managers to see such blocs as serious threats; instead, managers have tended to support efforts to negotiate regional free trade agreements, such as those between the United States and Canada and between the United States and Mexico, as well as the GATT negotiations. Their refusal to worry and their hopes for progress in the formation of regional groupings are apparent even when Europe is the issue. Although cries that a "Fortress Europe" might follow "1992" have indeed engendered some concern from managers of American multinationals that Europe might be closed to imports, recently attention has concentrated more on whether trade barriers within the Community really will disappear as scheduled.

Trade and investment patterns and the interests of multinational firms matter in the evolution of the world trading system. Since US multinational enterprises are major actors in international trade and investment, the patterns of trade they have established will determine to some extent the effects of any new trade regime on various countries; their investment and trade patterns will therefore have some impact on choices countries make in developing the system. Moreover, multinationals are likely to intervene directly in the development of the world trade system if they perceive that their interests are substantially affected. Although opposition on the part of American multinationals to integration in Europe might have little effect, within the Western Hemisphere their opposition to or support for such agreements might be decisive.

This paper will propose some hypotheses about the interests of US enterprises, with their supposedly global strategies. The data available provide considerable support for these hypotheses.

Gross figures reported in the press suggest that managers of multinationals should be concerned about the prospects of a breakdown in the current world trading regime. A system of protectionist regional blocs, some of these reports hint, would be quite harmful to firms. A recent article divided the globe into four zones — North America, the European Community (EC), Asia-Pacific and the rest of the world¹. In 1989, trade within these regions totalled \$1.5 trillion; trade between them amounted to \$1.6 trillion. More than half of all trade would thus be at risk should protectionist regional blocs come to dominate.

Managers may show little concern about the potentially negative impacts of regional trading blocs because they believe that these blocs are unlikely to be protectionist. On the other hand, it could be that even a deterioration of the world trading system into somewhat autonomous trading blocs would have little impact on managers of American multinationals. This paper will argue that the latter explanation is an important factor in generating the "big yawn".

Reports such as those cited above clearly exaggerate the threat. A significant amount of inter-regional trade is made up of petroleum, other minerals and tropical agricultural products, a substantial portion of which would almost certainly be exempt from serious trade restrictions even if regional blocs grew more important and turned protectionist. Petroleum alone probably accounted for more than 10 per cent of inter-regional trade in 1989. Further, the division of the world proposed by the report leaves more of the "rest of the world" outside the major trading blocs than would most forecasts. In reality, the Caribbean and South America would probably join North America in a Western Hemisphere bloc. Non-EC countries in Europe, as well as a number of Asian, African and perhaps a few Caribbean countries, would be absorbed into a European bloc. Such projected groupings reflect the current trade orientations of these countries. South America, for example, trades mostly with North America, and non-EC European trade stays substantially within Europe. In addition to raw materials trade, then, a large part of what is counted as inter-regional trade in the above figures is not at risk, since it would probably be captured within some regional grouping should the world move in that direction.

Whatever the correct figures for the amount of trade threatened by regionalisation of the world trading system, it is the theme of this paper that the so-called global strategies developed by US multinationals are even less seriously threatened by regional trading blocs than adjusted figures from overall trade imply. The evidence cited above suggests that substantially less than half of international trade is inter-regional now, but for US multinationals, protectionist regional blocs should have even less impact than these figures might indicate. Although the strategies of American multinationals are global in some senses, in other important ways they have generated patterns of trade and investment that are surprisingly regional and, with some notable exceptions, little affected by the emergence of regional blocs. The evidence also suggests a trend towards more, not less, regionalisation. Moreover, American multinationals could find themselves in a better position to exploit regional blocs than are their multinational competitors from other countries; some adjustments to a new regime might be required, but those adjustments may well be less than those required of competing multinationals, especially those from Japan.

The paper will argue that inter-regional trade plays a relatively minor role for most American multinationals in manufacturing. It will also argue that this trade pattern is not primarily due to managers' forecasts that trade rules will evolve to regional blocs; rather, the existing patterns arise out of past business strategies. Moreover, strategies for the future seem unlikely to lead to something sharply different. With current management technologies, the complexities of managing an enterprise with a truly global manufacturing system would probably impose costs on most firms that are greater than the benefits. Further, the typical gaming strategies that dominate

oligopolistic industries are little affected by the emergence of regional blocs. In industries for which inter-regional trade is significant — shoes and garments, for example — relations between the trading partners are typically established by contract rather than through ownership. The costs of shifting contractual relationships in response to trade restrictions are not perceived by US managers as huge. These three factors — existing trade and investment patterns, the management costs of manufacturing according to a truly global pattern and the role of gaming strategies — justify the equanimity which managers of US multinationals display when warned of the dangers from a regional trading system.

EVOLUTION OF STRATEGIES OF US MULTINATIONALS

The current distribution of subsidiaries and patterns of trade of a multinational firm are largely the results of past strategies. As the effects of past investments linger for decades, any attempt to understand the interests of US multinationals must begin with an effort to understand how past strategies have led to current patterns. One warning at the outset: any broad generalisation about the strategies of US multinationals must remain just that — a broad generalisation. There will inevitably be important exceptions to any general description. Nonetheless, historical patterns in the development of US multinationals are useful in understanding the current configurations and interests of those firms in the world trading system.

In the past, US firms rarely became multinational through a conscious strategy. Understandably, they were first and foremost interested in the huge domestic market. It was the domestic market that stimulated innovation. As the well-known theory of the product cycle suggests, that innovation was tilted heavily towards relatively high-income products for mass markets and towards labour-saving technologies².

Many US firms soon found foreign markets for the products that resulted from their innovations. Opportunities to sell abroad did not arise from low production costs in the United States; rather, it was the innovative lead of firms that enabled them to export, almost regardless of costs. Production costs for most innovative manufactures tended to be high in the United States, because of high labour costs. In Dunning's terms, the advantages of the innovative American firms in international trade were "firm-specific" rather than "location-specific"³. Those advantages were sufficiently great, for some period after innovation, that markets for many products could be exploited through exports from the high-cost home base.

Even in the past, the ability of US firms to supply foreign markets from US production sites typically declined as products and technologies matured. Production costs and trade barriers began to matter as imitators appeared. In response to threats to their markets, American firms established foreign subsidiaries to manufacture for foreign markets what had been produced at home and exported. The combination of the remaining firm-specific advantages (innovation and experience in production) and the location-specific advantages associated with foreign production temporarily kept competition at bay, at least for many firms.

This process generated the typical US multinational in manufacturing industries. Until sometime in the 1960s, one could describe such a firm as having its innovative activities concentrated in the United States and driven almost entirely by the US market. Its foreign subsidiaries manufactured principally products that had

been innovated for the US market and subsequently exported. The overseas affiliates had been established in response to threats to exports that eventually arose from transportation costs, tariffs and quotas, and lower factor costs abroad. Without such a response from US firms, exports would have been lost to local competitors.

Under the resulting patterns of investment and trade, sales of overseas manufacturing subsidiaries were limited almost entirely to the markets where they were located. Trade barriers played a role in the establishment of subsidiaries and often determined their original mission.

The strategies of some longer-established American multinationals had become more complicated even before the 1960s. Some foreign subsidiaries had taken on lives of their own. Set up originally to manufacture what had been innovated in the United States, they began to adapt products to the local market. In some cases, the subsidiaries had resulted from acquisitions of existing enterprises; the influence of the earlier product lines and acquired skills remained in the firm even after acquisition by a US parent. For example, the automobiles produced by American subsidiaries in Europe resembled less and less the automobiles manufactured by the parent firms in the United States; local demand and inherited skills and products had their influence.

Although many overseas subsidiaries eventually took on lives of their own, the structures of American multinationals were almost always designed for one-way flows of information and technology: from the parent to the subsidiary. Foreign affiliates had little impact on what was done in the United States. Innovations at home could be transferred abroad, but there were virtually no mechanisms for innovations abroad to come back to the United States, or to be transferred to third countries. US firms even had difficulty when they sought eventually to transfer small-car technology from their European affiliates to the United States.

Few efforts were made to use overseas subsidiaries as manufacturing sites for the US market. Costs may have been lower abroad than in the United States, but until the early 1970s few serious competitive threats emerged to upset the traditional manufacturing arrangements. Intra-firm trade, when it existed, involved principally the supply of components and complementary products to overseas plants from the United States. Again, a few exceptions can be found. With the increase in automobile imports from European firms to the US market in the 1960s, for example, US firms made some half-hearted efforts to bring home automobiles that they manufactured in Europe. The possibilities of adapting those autos to the US market were not exploited, however, and little effort went into marketing them. The risks of upsetting established manufacturing arrangements in the United States by cannibalising profitable sales from an oligopolised home market seemed too great in comparison to the cost savings. After all, imports from competing European firms were not taking that large a fraction of the US market. It would be another decade before Japanese imports would seriously challenge the hold of the US auto producers on their home market. The old trade patterns largely held.

The early history of most US multinationals is thus characterised by simple strategies. Foreign manufacturing affiliates produced primarily for the market where

they were located; the principal competitors to be watched were other US firms; and trade consisted largely of exports from the United States — little was traded among subsidiaries.

In the 1960s a few firms began to see advantages in integrating the operations of their foreign affiliates. Such integration occurred largely within Europe, as the European Economic Community lowered internal barriers to trade. The strategy of Ford Motor Company illustrates this point. Ford's European plants began to exchange components — e.g. certain transmissions and engines were exchanged between the German and British plants — to allow longer production runs for each item. Other US firms also began to integrate their operations within Europe. Their European headquarters began to take on a more important role, as co-ordination of the manufacturing activities of subsidiaries in various countries became necessary. These integrated manufacturing strategies were mostly limited to Europe (and to relations between the United States and Canada, especially in the automobile industry, where limited free trade arrangements appeared).

In the 1970s, traditional strategies were subjected to new threats. Foreign competition at home was becoming serious in a wide range of lines in which American firms had been dominant. From electronics to automobiles, imports began to threaten the home market in ways that could no longer be ignored by US firms, while economic changes meant that the United States could no longer serve as a major source of exports.

The changes had been several. To some extent, they were probably the inevitable result of time. Until the 1960s, European and Japanese firms, severely damaged by the war, had not been able to supply even the pent-up demand in their home markets. On occasion, governments had encouraged exports at the cost of the home market. In the early post-war years, for example, the British had allocated steel according to the export performance of automobile firms; the French had used price controls for similar ends. The resulting efforts to export remained somewhat half-hearted as long as demand at home appeared so attractive to European and Japanese firms. When shortages at home were relieved, however, European and Japanese firms turned to export markets, where they could exploit their location-specific cost advantages. The US market was an obvious target, but US domination of third markets was also threatened.

Catch-up was not the only source of new competition. Other changes eroded the firm-specific advantages that had so easily accrued to American firms in the past and brought some important firm-specific advantages to European and Japanese firms. In the 1970s the US market no longer looked so distinctly different, in terms of size, incomes and wage rates, from that of other countries. In the past, the products and processes innovated in the United States had soon faced growing demand abroad. Increasing incomes abroad meant expanding mass markets in other countries, which demanded the kinds of products that US companies had innovated in response to high domestic incomes. As a result, US firms ended up with skills that were especially suited for growing foreign markets. By the 1970s, however, when markets in Japan and Europe began to look strikingly similar to those in the United

States, Japanese and European firms were innovating products and processes that could compete directly with the innovations of US firms⁴.

In several ways the advantage began to shift away from US firms and towards foreign firms. First, falling trade barriers at home and declining transportation costs meant that US firms were no longer protected from foreign competition even in their home market. At the same time, foreign competition usually benefited from lower factor costs because of the special role of the dollar and the resulting exchange rates.

Placing even more weight on innovation seemed inadequate as a survival strategy for US firms; firms of other countries could quickly match US innovations. While the advantages accruing to US firms from the unique high-income home market were disappearing, rising energy and material costs in the United States gave advantages to firms that innovated products and processes that conserved on these factors. This is exactly the kind of innovation that characterised a number of firms in Japan and Europe. Japanese and European firms thus discovered that their skills found growing markets in the United States as energy and raw material costs rose world-wide. Japanese firms in particular had responded to the space constraints of a highly urban, densely populated island nation. With increasing urbanisation and growing populations elsewhere, innovations that involved downsizing, or even miniaturisation, found growing markets in other countries. The Japanese first entered the US market with small television sets, and they soon became low-cost suppliers of very small refrigerators.

Still another change was beginning to erode the traditional competitive strengths of US multinationals. Some firms, largely outside the United States, began to innovate for a world market, rather than simply for a home market. To date, most US product innovations had been designed to capture as large a share as possible of a mass home market. The sheer size of the US market supported this strategy. The resulting product was often not ideal for any one segment of the market, but it would sell well since costs could be kept very low through the large economies of scale that resulted from long manufacturing runs in specialised plants. The consumer would be willing to sacrifice some of his preferences in exchange for dramatic savings in price: the Model T and Model A Fords; cheap, standardised household appliances; the Kodak box camera; and so on.

In the 1960s and early 1970s, by contrast, some firms (particularly in Japan, but also in Europe), began to attack world-wide market segments, gaining economies of scale by serving large shares of smaller segments in many countries. The Japanese lowered costs on single-lens reflex cameras by mass producing for specialised market segments throughout the world. In the past, a US customer had faced limited choices: cheap mass-produced US cameras, or very expensive, low-volume German cameras. Now, the single-lens reflex was within the reach of many buyers, in the United States and elsewhere. Similarly, Japanese and European firms began to capture specialised segments of the US markets for automobiles (initially at the extremes — small, cheap cars and very expensive luxury and sports cars), electronics and small, aesthetically attractive kitchen appliances.

The attack on market segments previously held by low-priced standardised products of American firms was perhaps accelerated as new manufacturing technologies reduced the importance of scale in such a segmentation strategy. Smaller runs of a particular model bore lower penalties in terms of manufacturing costs than had been the case in the past.

As a result of these changes, US multinationals found themselves less able to use their home plants for exports by relying on firm-specific advantages. The shifting exchange rates that caused the dollar to rise in the 1980s increased the problem. Most US firms were exporting relatively little to their European and Japanese affiliates, which had become even more self-sufficient.

GLOBAL STRATEGIES — THE 1980s AND 1990s

Consultants and academics told management that changing competition required new strategies. Many observers called for global strategies. The US firm was to become truly "transnational", responding to market opportunities anywhere in the world, manufacturing wherever costs were lowest and shipping wherever markets existed. In many cases, observers called for a complete overhaul of the strategies of US enterprises, but change has not been as great as they envisaged. What others have dubbed the company's "administrative heritage", its "traditional distribution of responsibility, and its historical norms, values, and management style"⁵, as well as its existing configuration of manufacturing facilities, have all acted as a brake on change. Further, the economics of radically restructuring the geographic distribution of manufacturing appears less compelling than it once did. For most firms the management difficulties seem to outweigh the economic gains. Corporate strategies have been revamped, but the emerging patterns of manufacture appear more consistent with a world of regional trading blocs than the enthusiasm for global strategies might have led one to imagine.

The call for globalisation

Articles and books on how US firms must compete in global industries have proliferated, yet globalisation of business strategies has meant different things to different writers⁶. Thus arise the differences in opinion as to how global US firms already are, and the differences in prescriptions for globalisation. If American firms were to become global in the sense intended by many writers, the evolution of regional trading blocs would force US business to rearrange its facilities, at substantial costs; other global business strategies would allow for the current and future globalisation of US business in ways that would not be in conflict with regional trading blocs.

The essential difference between global strategies lies in what activities of business are, or should be, globalised. Much is written on production, but production is not globalised in many firms. Indeed, there is ample evidence that a firm can globalise other functions without globalising production, and that most firms have chosen this route.

The literature on global strategies generally starts with the firm's need for a strategic response to competing firms that operate in multiple national markets. A global strategy takes into consideration the actions of other firms that operate internationally — often firms of different nationalities. This response might be made up of elements of the company's approach to scanning, operating style, marketing strategy, new product development policy, human resource policy, R&D focus,

communications systems, financial policy, investment policy, partnership policy and sourcing policy⁷.

It is manufacturing, or sourcing policy, that counts when a manager evaluates the impact of restrictions on trade. The enterprise can follow global strategies with respect to finance, product design, advertising and so on without having to worry about restrictions on the movements of goods across regions. In contrast, if emerging manufacturing strategies rely heavily on the movement of goods across regions, regional trading blocs pose a serious threat to the American multinational.

The definition of global strategies used by many authors suggests that goods must move in complex patterns within the global multinational. Keegan, for example, defines the global corporation as sourcing "product from best source (cost, market access, stakeholder priorities considered world-wide to supply served markets)"⁸. Porter describes a global strategy thus: "The global competitor can locate activities wherever comparative advantage lies, decoupling comparative advantage from the firm's home base or country of ownership."⁹ The resulting manufacturing pattern **may** involve supplying the world from one source, labelled by some "a centralised hub", or locating different parts of the process in different countries with differing factor costs, and trading components and products across borders, in a "networked" configuration¹⁰. Either pattern is likely to result in a great deal of inter-regional trade, from the central plant outward, or among globally "networked" facilities.

The usual arguments for globalised production systems are based on the presumed need to exploit international differentials in production cost on a world scale. The feasibility of a dispersed manufacturing network has, according to its proponents, increased as transportation and telecommunication costs have declined¹¹. Further, new technologies have evolved that render skilled labour less necessary, making the exploitation of low-skilled, low-wage labour in certain countries more feasible for some parts of the manufacturing process.

Arguments on the other side suggest that the gains from widely dispersed facilities may be small. Japanese-style "just-in-time" manufacturing systems discourage the division of the manufacturing process into geographically separated units. Shipping times, and especially the uncertainty involved in shipping over distances, encourage clustering of component suppliers and assembly (as in G.M.'s Saturn project). Available management tools may simply not be adequate for the transfer of information and the co-ordination of widely dispersed production facilities, and even if such management systems are possible, the costs of co-ordinating widely dispersed manufacturing systems may outweigh any advantages to be gained¹².

Globalisation in practice

The pattern that has emerged is first and foremost one in which the US multinational produces abroad for the market where its affiliates are located. Production that is not for the local market is destined no further than the regional market. There are important exceptions, yet the dominant pattern is not one of world-wide exchange of products and components, as some proponents of global strategies seek. Nor is it one of the centralised hub, with manufacturing concentrated in US

plants that serve the world market. Costs are too high, given the value of the dollar, and competition too severe. The dominant pattern for US firms — production for local or regional markets — stands in contrast to the dominant pattern for Japanese firms, where manufacturing remains even today, in spite of recent change, more centralised in Japan, and foreign markets are served through exports.

Consider first the extent to which US firms manufacture abroad instead of exporting. During 1988, exports of manufactured goods from the United States were \$256 billion¹³, while sales by foreign manufacturing affiliates of US firms were \$620 billion. Of the exports, \$174 billion were accounted for by manufacturing parents of foreign affiliates. Thus these manufacturing multinationals sold, gross, from their foreign affiliates close to four times what they exported from the United States. If one subtracts US exports to overseas affiliates from sales of those foreign affiliates, conservatively assuming that these are all complementary exports that are double-counted in affiliate's sales, manufacturing overseas of US multinationals amounts to some \$446 billion, still more than two-and-a-half times the exports of the parent firms¹⁴.

This dramatic change from old patterns is a response to the environment, not to managers' natural preferences. Exports have generally been managers' favoured way of serving foreign markets. Even though costs of labour and other production factors might well be cheaper in other countries, and import tariffs can be avoided by foreign manufacture, advantages of scale, simplicity of management and plain inertia lead most managers to prefer exports over foreign manufacture. US firms relied on an export strategy as long as US enterprises had substantial advantages from their innovations, that is, as long as no one else took advantage of the gains from foreign manufacture. Today, that export approach is no longer viable, since in most industries foreign competitors stand ready to exploit cost savings abroad to compete with US firms that fail to do so. While the establishment of foreign production has long been the response of managers when exports were threatened, and that process has often been accelerated by trade barriers abroad, recent changes have been such that foreign manufacture now overwhelms exports from home plants.

It is perhaps ironic that in a world of falling trade barriers US firms shifted their emphasis from trade to local manufacture, but that shift appears to have been largely due to the loss of distinctive advantages that had enabled them to manufacture in and export from the United States, a high-cost site.

US multinationals continue to export, but a substantial part of their exports from the United States goes to destinations within the Western Hemisphere, and thus would not be affected by the emergence of trading blocs. Breakdowns of 1989 data do not separate manufacturing exports by destination, but of all exports by US multinationals, about one-third remained within the Western Hemisphere¹⁵. Of US manufactured exports to affiliates, close to two-thirds were within the Western Hemisphere in 1988¹⁶.

The predominance of foreign manufacture, as opposed to exports from the United States, and the hemispheric focus of US exports of manufactures to affiliates do not necessarily mean that trade restrictions are unimportant to the multinational

firm. The products of overseas affiliates could themselves be exported, to the United States or to other markets. In fact, the global "networked" strategies proposed by many authors would require just such specialisation of foreign affiliates and trade among those affiliates. Under such a global network, trade, and thus multinationals' strategies, could be threatened by trade restrictions.

Trade data for 1989 show that so-called globalisation has resulted primarily in local or regional sales. For that year, sales of majority-owned foreign manufacturing affiliates were \$505 billion. Of that, \$320 billion was sold in the country of manufacture. Given the propensity of US multinationals to export primarily from wholly or majority-owned operations¹⁷, inclusion of minority-owned affiliates would have made the data even more striking.

Although close to two-thirds of the sales of overseas affiliates of US multinationals are made in the local market, exports from those affiliates still amount to a substantial figure and could make trade restrictions worrisome to the multinational manager. Under globally "networked" strategies that seek out the cheapest location, shipping products as far as necessary to relevant markets, a large part of these exports would presumably cross regional boundaries, leaving them exposed to the threat of restrictions on inter-regional trade. In fact, a large proportion of the exports of the affiliates of American multinationals are destined for other countries in the affiliate's own region.

Consider first the Western Hemisphere and Europe. The data in Table 1 indicate that roughly three-quarters of the exports of US manufacturing affiliates abroad are sold within these two regions. If a Fortress Europe and an inward-looking Western Hemisphere trade area were to develop, about three-quarters of the exports of US manufacturing affiliates would not be threatened by new protectionist measures covering inter-regional trade. On the other hand, reductions of barriers within the regions would be helpful to these flows. No wonder, then, that so many US managers seem unconcerned about the possibilities of a regionalised trading world.

The remaining balance of exports from affiliates outside these two regions accounts for only about one-twelfth (one-quarter of one-third) of the sales of foreign affiliates. Affiliates in Japan and "other Asia and Pacific" countries are the only ones that have a significant fraction of their exports destined to markets outside their own region (see Table 2). These Asian exports are shipped overwhelmingly to the US market, yet the figures for them are strikingly small. Those from "other Asia and Pacific" countries make up only 10 per cent of the total exports of US affiliates. Exports out of the region from affiliates in Japan are about 1 per cent of the total.

These low figures for exports from Asian affiliates must make some readers wonder why there is such a clamour about imports of Asian low-wage products into the United States. The answer lies in the fact that imports from affiliates account for only a small part of US imports from Asian sources.

US multinationals frequently seek low-cost products abroad for the US market. When they feel compelled to have their own plants abroad, however, they locate those plants overwhelmingly within the Western Hemisphere, where transportation is quick

and cheap, and where communication is easier. For example, US automobile firms have a propensity to obtain labour-intensive components from Mexico rather than from Asia.

Most US imports from Asia are simply not manufactured by the affiliates of US multinationals in Asia. When the advantages of low-cost Asian labour are so attractive that a Western Hemisphere location is less appealing than an Asian site, American firms have tended to contract out manufacturing rather than establish affiliates. In 1987, only 5.4 per cent of US imports from Taiwan came from US-owned affiliates in Taiwan; the figures for South Korea and Thailand are 4.8 per cent and 15.1 per cent respectively¹⁸. Most US imports of manufactures from Asia are therefore arms-length purchases. More recent data from Indonesia also illustrate the point. Although manufactured exports from Indonesia to the United States were booming, in the first seven months of 1990 not one US-owned exporter appeared in the list of incoming investors approved by the Indonesian investment authority. Foreign investors for export projects came overwhelmingly from Korea, Taiwan and Hong Kong, although a large part of their output was destined for the US market.

The highly publicised electronics industry has been an exception to some extent. The principal exceptions to the figures just cited are imports from Singapore and Malaysia, which include substantial amounts of electronic components shipped to affiliated enterprises¹⁹. [A significant part (about 30 per cent) of the manufactured imports from other Western Hemisphere countries (excluding Canada, for which the figure is considerably greater than 50 per cent) comes from affiliates of US multinationals²⁰.]

Although regionalisation would have relatively little effect on intra-enterprise sourcing of low-wage imports by US multinationals, it could threaten imports by US firms from low-cost Asian sites. Since such imports take place largely through contractual arrangements rather than trade with affiliates, these are exactly the trade flows to which US multinationals have the least commitments. Contracts for products and components can be rearranged in response to changing trade restrictions. Sourcing can be shifted to Latin America or the Caribbean. The disruption for the US firm would, in many cases, be relatively minor. After all, contractual relationships (as opposed to ownership) govern the sourcing largely because possible suppliers are numerous, since technological and capital barriers are low. Given the many possible suppliers, switching would not upset the US firm.

The burden of change would likely fall heavily on the Asian countries now exporting. If the US firm shifts its source from East Asia to Latin America, the company that supplies from Latin America might even be the former supplier from the Far East. In this event, disruption to the multinational would be especially small, since proved suppliers would be involved. Korean, Taiwanese and other Asian firms have already shown a willingness to locate plants elsewhere in response to changing economic conditions. As their home countries become uncompetitive because of shifting exchange rates, increasing wages, "voluntary export restraints", or loss of GSP status, they have moved entire plants to, and established new ones in, Thailand, Indonesia, and elsewhere in Asia²¹. Korean and Taiwanese investors account for much of the recent growth in manufactured exports from Indonesia, as mentioned

above, even though the exports themselves are destined largely for the US and European markets. There is some evidence already of Asian suppliers' willingness to locate plants in the Americas. Costa Rica, for example, has attracted Korean firms to manufacture there for the US market²². In response to regional trading blocs, these Asian firms would probably prove quite mobile, as they have in the past, finding moves even across the Pacific to be tolerable.

Regardless of the globalisation of other functions, the most recent data suggest that manufacturing systems of US multinationals largely remain locally or regionally oriented. In fact, regionalisation appears to have increased since 1982. Table 3 indicates that a somewhat smaller fraction of affiliate exports were regional in 1982 than in 1989.

There are some widely reported and significant exceptions. While Ford, for example, has integrated its plants largely on a regional basis, General Motors claims to have integrated its plants more globally. In its most recent Saturn plant, however, General Motors has retreated from this approach, citing the difficulties of running a just-in-time plant with distant suppliers. IBM, another exception, claims to conduct more than the usual amount of trade among its affiliates across regions. Nonetheless, these and other important examples are, if the data are to be believed, not the dominant strategies for US multinationals.

Although the data suggest that the manufacturing strategies of US multinationals are more regional than global, they do not imply that US firms have neglected other kinds of global strategies. Multinationals have long followed different approaches for different functions within the organisation. Although manufacturing may be largely local or regional, world-wide pricing decisions might be centralised in pharmaceutical firms, for example, although they will likely be left to regional or local managers in detergent firms. Finance tends to be centralised in most US multinationals even when other functions are handled on a regional or local basis. The US multinational may well be increasingly responding to market opportunities in other countries, but for trade restrictions, it is product flow that counts.

Why is manufacturing not "global"?

Why, despite calls for global manufacturing systems, have American firms organised manufacturing largely on a local or regional basis? The reasons are important. If the current pattern and recent trend are anomalies, and the future is in globalisation of manufacturing, then a move towards regional trading blocs will disrupt the process and might well eventually be opposed by managers. If, however, the benefits to the firm of cross-regional trade are actually smaller than the costs of such trade, then a trading system of regional blocs will remain of little concern to managers of American multinationals. Have the managers implicitly or explicitly weighed the gains from exploiting different factor costs and from economies of scale and found that they do not offset the costs of cross-regional manufacturing systems?

The most likely reasons are the following: (1) The gains from rationalising manufacturing across regions are lower than most proponents of global manufacturing have made them out to be; most of the economies, from scale or from differing factor

costs, can be obtained within a region. (2) The difficulties of managing a world-wide integrated manufacturing system are still overwhelming, in spite of improved communications and increased experience. (3) Strategies that typically are attractive to managers in oligopolistic industries do not aim to drive costs to the very minimum; rather, such strategies revolve around efforts to minimise the risks that the firm will be damaged by moves of a competitor. Regional manufacturing systems are quite compatible with such strategies. We will now consider each point separately.

The centralised hub approach to manufacturing makes little sense for most US multinational firms. The United States is a high-cost site for most manufacturing, and the political sensitivities abroad to having little local value added are great. The advantages of supplying the world from centralised US facilities are therefore few. As our historical analysis suggests, American multinationals began this way — producing at home and exporting to other markets — but costs and political sensitivities soon led them to manufacture abroad. The aircraft industry has, historically, been an exception, the industry that comes the closest to following a centralised hub strategy in its manufacturing. Yet even in this case, growth in foreign competition and pressures from foreign governments have led the industry away from doing all its manufacturing in the United States.

A US firm could, in theory, follow a centralised hub strategy by establishing its single manufacturing site in some other country where costs are lower than at home. In so doing, it would still not escape the political pressures in the countries where it sells. Presumably, it would also face pressure at home from its unions and the government to avoid such a radical move. Moreover, managers would see great risk in "placing all their eggs in one foreign basket", and organisational inertia would make such a radical step quite unlikely²³.

The alternative "networked" approach would allow the firm to gain economies of scale and to take advantage of comparative advantages in different production sites. The data cited earlier indicate that firms have not acted this way.

The gains from inter-regional integration of manufacturing seem to be much lower than some of the literature would suggest. Most manufacturing economies can be exhausted in manufacture for regional markets. The scale gains from plants that manufacture for markets larger than the Western Hemisphere, Europe or possibly East Asia are surely quite small. Moreover, the gains to be teased out of very large-scale facilities are probably declining with the emergence of new manufacturing technologies²⁴.

Similarly, automation of many manufacturing processes has proceeded to the point where access to low-cost labour has become an insignificant factor in location decisions²⁵. In the 1970s, semiconductor manufacture moved, to a large extent, to South-East Asia in search of very low-cost labour. Now, however, location decisions in this industry appear to be based principally on proximity to related upstream or downstream operations and on the availability of technical skills, rather than on minimising labour costs. Electronics exports from American affiliates in the Far East continue, as a result of the skills built up from past investments, but where past investment has not existed, low wages alone are often not sufficient to attract

investment by US firms. Indonesia is an illustration: despite wages now much lower than in Malaysia and Singapore, the country has not been successful in attracting US electronics firms. At the same time that wage costs, and probably scale, are declining in importance to the multinational, in many industries production costs themselves come to matter less, as marketing and distribution costs have climbed as a percentage of the final price²⁶. Possible gains that might be squeezed out of optimal plant locations are thus less important.

Even when opportunities to profit from different factor proportions are substantial, they can generally be exploited within a region. As the regions that might become trading blocs offer a wide range of "factor proportions", most of the gains from comparative advantage could be captured within them. Products for which wage costs are still critical can be manufactured for the Western Hemisphere in the Caribbean or Mexico, for example; for Europe, in Ireland, Turkey or perhaps North Africa; for Asia, the opportunities are manifold. Similarly, each region has its own centres of highly skilled technical personnel. Since both low-cost labour and skilled labour are usually available nearby, there is no incentive to incur higher co-ordinating costs from long-distance sourcing.

Raw materials are another story. Acquiring certain raw materials outside the regional blocs is frequently an advantage, but, as pointed out earlier, there would be little threat to such trade when the advantages to the bloc from external sourcing are very apparent. Such imports are unlikely to be targets for protectionist policies. Thus the manufacturing multinational will probably have access to the fuel, metals and so on that it needs, regardless of its location. Even in the absence of easy access, firms will face problems no different from those of their competitors within a region.

While the gains from inter-regional rationalisation of manufacturing are probably not what they seem, the costs to the enterprise of co-ordinating facilities across regions appear to be high. Communications costs grow sharply with distance, despite the lowering of real airfares and telecommunications rates. Problems of time zones intervene, and linguistic and cultural barriers often increase with inter-regional manufacturing. To some extent, distant manufacture inevitably means that time between manufacture and delivery to the market increases, leading to larger inventories and higher risks of product obsolescence.

The co-ordination and control mechanisms needed to run a dispersed manufacturing system have been widely explored²⁷. Much recent literature on the organisation of multinational firms has aimed at finding ways around the choices that multinationals have usually had to make to overcome the problems of distance while maintaining responsiveness to local markets and governments. Traditional organisational structures forced managers to choose a product focus or a regional focus for co-ordination. It is this choice that recent writers have sought to avoid, at least for certain parts of the enterprise²⁸.

Despite widespread efforts by academics and consultants to tell managers how they should organise and manage to overcome the problems of distance, there have been no serious efforts to measure the actual costs involved in co-ordinating international manufacturing operations, and how those costs differ with various

measures of distance. The task is daunting: the costs to be compared across differently dispersed manufacturing operations include management time, valued at its opportunity costs, direct costs of travel and communications, and costs associated with differing and uncertain quality and delivery schedules²⁹. Despite the lack of data, the abundant literature on the subject points up the extreme difficulty of co-ordinating and controlling a dispersed production system. Anecdotes abound. Ford, for example, is said to maintain its own air shuttle service among plants in Europe — a communication device that would be prohibitively expensive for inter-regional co-ordination. Efforts at limited rationalisation of production processes have an impressive record of failures and lengthy adjustment times³⁰.

The difficulties of cross-regional control are evident in the fact that most US multinationals are organised, at some level in their hierarchy, along regional lines, like the trade patterns described earlier. Studies in the early 1970s found that firms with little product diversity were moving towards regional divisions, and more diversified firms were tending towards world-wide product divisions, as their businesses became more international³¹. Even the latter, however, have usually retained a regional focus for co-ordination below the division level. Manufacturing operations are almost always co-ordinated at the regional level — through regional divisions, regional task forces or whatever approach the firms choose — rather than across regions. The difficulties of managing complex activities that lie in separate parts of the organisation, which would plague the co-ordination of manufacturing operations located in different regions, have been carefully described³². They have seemed to pose almost insurmountable barriers to cross-regional management of complex manufacturing operations in most US multinationals. In reaction to what one group of authors calls "global mania", some multinationals that had followed popular advice on global organisation seem to be retreating and placing more emphasis on regional structures and strategies³³. Optimism persists that these co-ordinating costs can and will be lowered, either through organisational change³⁴ or through technological progress³⁵, but declining returns to scale, declining importance of manufacturing costs themselves, and the opportunities to exploit comparative advantage within a region make one wonder why many firms would want to push integration of manufacturing beyond the regional level. It appears that most, in fact, do not attempt to do so.

Minimising costs is not the only factor that drives decisions about production location. Multinational enterprise is largely the product of oligopoly. Absolute cost minimisation is rarely the dominant strategy in oligopolistic industries. Rather, many firms use part of the margin that oligopoly conveys to follow more complex strategies, often designed to reduce risks rather than costs. Other researchers have documented the common "follow-the-leader" and "hostage" strategies that drive some investment decisions by multinationals³⁶. Today, most oligopolistic industries include significant firms from all three parts of the so-called Triad: North America, Europe and Japan. Increasingly, international strategy is driven by rivalry among players from these three regions. The goals of strategy are usually complex, and often not explicit, but hidden under rules of thumb, such as the need to "be present" in all three areas of the Triad. "Presence" may take the form of manufacturing affiliates directly owned by the multinational firm or of strategic alliances with other firms, structured in various ways for the exchange of technology and information. Protection against potential trade barriers can be the underlying goal of a Triad strategy, but other considerations are

likely to be equally important: the security that seems to derive from monitoring competitors' development of technology, possible cost sharing for research and development, insurance against disruptions of major markets by competitors and so on. The principal goals, no matter how complex, are likely to be dominated by efforts to create stability among a small number of potential rivals rather than to drive manufacturing costs to their ultimate minimum. Most important, these oligopolistic strategies would generally not be threatened by the development of regional trading blocs. In the pursuit of such strategies, major US multinational firms have already installed themselves rather securely inside each potential bloc, or are well on their way to doing so. Not only does regional investment seem to meet their needs with regard to manufacturing costs, it also satisfies the need to respond to competitors in oligopolistic industries.

INVESTMENT AND REGIONAL TRADING BLOCS

The attitude of managers of US multinationals towards regionalisation of trade regimes depends on the effects that such a trend would have on their businesses. If trade of US multinationals is substantially regional, despite the largely global trading system currently in place, then managers of such enterprises are justified in their indifference to the debate about the prospects of regional trading blocs.

On the other hand, if the trade of those firms were substantially cross-regional today, or on its way towards such a pattern, then movement towards a regional trading system might well be of concern to managers -- it would require considerable adjustment to the firms' investments and trade patterns. The costs of that adjustment might well put US firms at a competitive disadvantage to firms of other countries that had established trade and investment patterns more consistent with the alternative trade regime. The available data strongly suggest that the manufacturing systems of US multinationals are indeed regional and would be largely unaffected by a rise in the importance of regional trading blocs. Moreover, what is known about their strategies suggests that the trade of US multinationals is likely to remain mostly regional. The managers' lack of concern seems, on the surface, quite rational. The emergence of regional trading blocs could, however, threaten US strategies in another way. If those blocs were to restrict foreign investment and, still worse from the firms' point of view, discriminate against foreign firms already established within the region, American firms' ability to serve those markets through affiliates in the region could be severely threatened. Given the past and current strategies of US multinationals, it is restrictions on capital movements rather than on trade that would lead to severe disruption.

Managers of US multinationals show little fear with respect to restrictions on foreign investment. Again, their complacency appears justified. Their experience with the EC does not suggest that such restrictions on their activities are likely. The creation of the Common Market meant easier access for foreign investors, rather than increased barriers. Individual countries that attempted to restrict investment — France, for example — found their restrictions undermined by other countries in the EC, such as Belgium, that were eager for foreign investment and could offer unrestricted access to markets in other EC countries. Barriers to foreign investment tended to fall to the level of the lowest among the member countries. Despite the occasional efforts on the part of some members to erect EC-wide barriers to the penetration of foreign investors, economic integration induced competition to attract foreign firms rather than co-operation to exclude them.

Change could be in the wind. It may be that American managers underestimate the importance of recent European restrictions on Japanese products

in the EC. These restrictions limit sales in the EC even if the products are manufactured by Japanese companies within Europe — through so-called transplants — but these efforts have met strong internal resistance. Once a firm from outside the EC offers to establish production in a country, it quickly creates an ally in the bloc. The British, for example, have resisted restrictions on exports to other EC members of automobiles made in Britain by Japanese firms. Their efforts have not been entirely successful, but they have resulted in a scheduled phase-out of restrictions on Japanese cars.

Much like the EC, other trade blocs have not been able to enforce restrictions on incoming investment for long. Perhaps the most stringent rules on outsiders were those of the Andean Group, which were explicitly designed to limit foreign firms' ability to exploit the advantages of an integrated market so that locally owned firms could capture the gains. Even in this relatively nationalistic group of Latin American countries, however, the agreements soon collapsed as individual countries saw prospects of capturing regional markets by inviting foreign-owned firms to their territories. An Asian bloc would probably behave similarly. In fact, an East Asian bloc would almost certainly result in a more liberal foreign investment regime than that of its dominant member, Japan. Were Japan to be integrated into an East Asian free trade agreement, access to the Japanese market might be easier for American firms than it is today. A US firm would probably find a warmer welcome should it wish to establish a subsidiary in, say, Thailand to serve the Japanese market than it would today if it were to establish a subsidiary in Japan for that market. As in other integration efforts, barriers to foreign investment would probably fall to the lowest common denominator.

Explicit restrictions on foreign investment also matter somewhat less today than in the past. Firms have developed alternative ways of operating within foreign markets. Obvious foreign direct investment is no longer as essential as it once was. Arrangements that look much like the old co-production agreements of Eastern Europe, for example, have been used by the Japanese recently in South-East Asia, avoiding the cumbersome bureaucratic approvals required of openly foreign investors³⁷. Such arrangements have had the Japanese firm provide equipment to an existing local manufacturer. In exchange, the local firm agrees to repay a corresponding debt in the form of products produced by the equipment and to put the operation under the control of managers provided by the Japanese. Technically, there is no foreign direct investment, yet all the advantages of ownership are likely to be available to the foreign firm. Alliances among firms of different nationalities have provided another important way of exploiting foreign markets without straight foreign direct investment. Complex alliances among rival firms in different markets can grant market access without the need for foreign investment.

In sum, managers have little to fear from investment restrictions in regional groupings. Experience suggests that they are unlikely to be in place for long, and new investment techniques allow firms to avoid them, at least to some extent.

REGIONAL TRADING BLOCS AS SOURCES OF ADVANTAGES

Warnings of the potential of "Fortress Europe" now elicit almost unanimous boredom from managers of most US multinationals. The reason is perhaps not that managers have failed to think about or do not understand the issues, but more likely that the impact on their businesses would be much lighter than might be supposed. With well-established manufacturing affiliates within the EC, these firms have little fear of limits to expansion or to new investments.

In fact, the interests of most American multinationals lie in further integration of European markets: with their investments in place across Europe, many such firms are in a better position to exploit European strategies than are their Japanese competitors, who have depended much more on inter-regional exports to European markets, and the US firms may be in a better position than the Europeans themselves, who have tended to supply European markets from their home plants³⁸. Instead of gaining from the opportunities to build "greenfield" plants, the Japanese, as the latecomers, are facing more difficulty in replacing trade with investment. Despite the confidence of American managers, policies of openness to foreign investment are not always what they seem. One example at the industry level is shown in Table 4, which breaks down by place of final assembly the production of various vehicle manufacturers. Japanese manufacturers still assemble a larger percentage of their automobiles at home, though their home market is smaller than the US market. Exports out of their home country, and out of their region, are particularly important to them. The Europeans assemble less than the Japanese at home, but more in their own region than the Americans (for a total of 91 per cent within Europe). The Americans assemble 71 per cent within the Americas, but close to a third of their production is assembled elsewhere, largely in Europe. In addition, the Japanese response of simply adding more local value in Europe has been made less rewarding by the recent step in the EC (mentioned earlier) of temporarily counting vehicles from Japanese plants in Europe in quotas as if the cars had been made in Japan. Although Japanese strategies are changing rapidly, the lack of local value added has left them the most exposed to the development of regional blocs; they are particularly vulnerable to trade and investment restrictions. Moreover, as newcomers the Japanese are viewed as being "more foreign" in Europe than are the Americans³⁹.

Although the current positioning of US multinationals in Europe does not mean that they can ignore the need for new investment in response to Europe 1992, the Americans appear to be better prepared for the emergence of regional trading blocs, since they typically have established plants long ago in major markets.

Like Europe 1992, negotiations for trade agreements between the United States and its neighbours in the Americas have generally been applauded by managers. The Business Roundtable, for example, has come out in support of trade agreements in the Western Hemisphere⁴⁰. American Express worked hard in support of the US-Canadian agreement. As in Europe, established US multinationals, with facilities throughout the hemisphere, are in a strong position to gain from such integration, even though some adjustments would be required.

US business has not shown uniform support for Western Hemisphere agreements. A North American trade bloc, or a Mexican-US agreement, would be a threat for some US firms, particularly those that are not multinational. Without sources of manufacture in countries with low-cost labour, purely national firms in some industries are indeed threatened by duty-free imports from Mexico or other low-cost sites. The threat for those firms would be identical, however, were US trade barriers simply lowered for imports from the whole world, not just from the Western Hemisphere. These firms object to freer trade, not just to more liberal hemispheric trade.

CONCLUSIONS

It is easy to understand why most managers of American multinationals view with indifference the prospect of a world broken into regional trading blocs. Manufacturing firms have built their manufacturing strategies largely on regional patterns. In view of the relative costs and benefits of more global strategies, there is little reason for change. Further, currently popular strategies — those actually practiced, not necessarily those proposed by academics — seem quite consistent with the emergence of trading blocs.

This is not to say that managers of US multinationals are indifferent to trade. Many have strongly supported progress in the Uruguay Round, for example. The Round has been soundly backed by the MTN Coalition, some 14 000 companies. The Business Roundtable, the National Association of Manufacturers, the National Federation of Independent Businesses and the Chamber of Commerce have all lined up behind the negotiations⁴¹. Since US multinationals have profited by the reduction of trade barriers within Europe and would likely benefit more from a successful "1992", managers seem eager for further lowering of trade barriers within regions. They have proceeded along the same path within the Western Hemisphere, with substantial trade under the various agreements for automotive trade with Canada and investments in Mexico and the Caribbean for the US market. Although some imports from the low-wage Americas are already duty free under the Caribbean Basin Initiative, the Generalised System of Preferences and tariff provisions 806 and 807⁴², the recent agreement with Canada and prospective agreements with Mexico and the rest of Latin America promise even more opportunities to exploit existing investments and new investments that are simply extensions of current strategies. If these agreements for freer intra-regional trade lead to greater inter-regional barriers, the costs to most American multinationals would not be great, and the costs to their competitors might in some cases be greater.

Not all US firms have followed the strategies of the multinationals that are the subject of this paper. Firms without foreign affiliates have their own strategies. Nor has the paper attempted to explore the implications for firms whose activities are not primarily manufacturing. US multinationals engaged in providing services have increased their activities abroad, and thus are likely to have an interest in the kind of world economic regime that the future holds, but services are provided largely through investment rather than through trade. The trade restrictions that regional groupings are likely to impose at their borders have little direct effect on such multinationals, but regionalisation has secondary, more subtle effects that are difficult to predict. For example, regional agreements on standards for services and on qualifications of

service professionals within regional groupings may affect the competitiveness of outsiders, but the effects depend on the approach — harmonisation, common standards or mutual recognition — and on whether firms owned outside the region and foreign professionals are recognised as nationals.

This paper has also not dealt with multinationals that produce raw materials. Inter-regional trade of some of these products is not likely to be restricted, even with the emergence of strong regional blocs. Petroleum, for example, will probably be welcome whatever its source. Restrictions on other minerals are unlikely. Trade in some agricultural products might well face even greater restrictions than today, but most trade by American multinationals in these products is already regional — witness, for example, the flow of bananas.

Although US manufacturing multinationals may reasonably view a movement towards regional trade with equanimity, that does not mean that the US government, or those of other countries, should be neutral. American multinationals' widespread indifference to regional blocs does not imply that a movement away from a global trading system towards such blocs is beneficial for the world, or for particular countries. Nor does it indicate that a move to regional blocs is inevitable, or even likely. The probabilities of various trading systems, as well as their benefits and costs to individual countries and to the world, are the subjects of other papers in this research programme⁴³.

NOTES AND REFERENCES

1. *The Economist*, 8 December 1990, p. 11.
2. See, for example, W.H. Davidson, "Patterns of Factor-Saving Innovation in the Industrialized World", *European Economic Review*, Vol. 8, No. 3, October 1976, pp. 207-217; Raymond Vernon, *Sovereignty at Bay* (Basic Books, New York, 1971); Louis T. Wells, Jr., ed., *The Product Life Cycle and International Trade* (Harvard Business School Press, Boston, 1972). The role of the home market in determining innovation has recently re-emerged in the literature; see Michael E. Porter, *The Competitive Advantage of Nations* (The Free Press, New York, 1990).
3. John H. Dunning, "The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions", *Journal of International Business Studies*, Spring 1988, pp. 1-31.
4. The process of change is described in much greater detail in Raymond Vernon, "Gone Are the Cash Cows of Yesteryear", *Harvard Business Review*, November-December 1980, pp. 150-155.
5. See Christopher A. Bartlett and Sumantra Ghoshal, "Organizing for Worldwide Effectiveness: The Transnational Solution", *California Management Review*, Vol. 31, No. 1; and Susan P. Douglas and Yoram Wind, "The Myth of Globalization", *Columbia Journal of World Business*, Winter 1987, pp. 19-29, reprinted in Heidi Vernon-Wortzel and Lawrence H. Wortzel, eds., *Global Strategic Management: The Essentials*, 2nd ed. (John Wiley & Sons, New York, 1990).
6. An excellent early overview of the subject is found in a two-part article by Bruce Kogut, "Designing Global Strategies", *Sloan Management Review*, Summer and Fall 1985; the debate about global or multinational strategies and the retention or disappearance of national identity of multinational firms is summarised in C. Fred Bergsten and Edward M. Graham, "Global Corporations and National Governments: Are Changes Needed in the International Economic and Political Order in Light of the Globalization of Business?", mimeo [Institute for International Economics, Washington, D.C., n.d. (1990)].
7. See Warren J. Keegan, "The Global Business and Its Strategy in the 1990s: Issues, Opportunities, and Challenges", in *Advances in Telecommunications Management*, Vol. 2 (JAI Press, Greenwich, CT, 1990).
8. *Ibid.*
9. Michael E. Porter, ed., *Competition in Global Industries* (Harvard Business School Press, Boston, 1986), p. 37. Porter goes on to point out that it is not simply manufacturing that lends itself to gains from globalisation.
10. *Ibid.*, p. 49.

11. Therese Flaherty, "International Sourcing: Beyond Catalog Shopping and Franchising", in K. Ferdows, ed., *Managing International Manufacturing* (North Holland, New York, 1989), pp. 95-124; C. Antonelli, "Multinational Firms, International Trade, and International Telecommunications", *Information Economics and Policy*, Vol. 1, No. 4, 1984, pp. 333-343.
12. See Porter, *op. cit.* (1986), p. 44, for the first position. For an empirical study, see the forthcoming Harvard Business School doctoral dissertation of David Levy.
13. Victor B. Bailey and Joanne Tucker, *U.S. Foreign Trade Highlights, 1989* (US Department of Commerce, International Trade Administration, Washington, D.C., September 1990), p. 51.
14. For interesting and more sophisticated calculations of the relative size of trade and foreign manufacture of US firms, see DeAnne Julius, *Global Companies and Public Policy* (The Royal Institute of International Affairs, London, 1990), and a summary of her data in *The Economist*, 22 December 1990, p. 44.
15. *US Direct Investment Abroad: 1989 Benchmark Survey, Preliminary Results* (US Department of Commerce, Washington, D.C., November 1991), Table 86.
16. *U.S. Direct Investment Abroad: Operations of U.S. Companies and Their Foreign Affiliates: Preliminary 1988 Estimates* (US Department of Commerce, Washington, D.C., July 1990), Table 16.
17. See John M. Stopford and Louis T. Wells, Jr., *Managing the Multinational Enterprise* (Basic Books, New York, 1972).
18. "Shifting Patterns of U.S. Trade with Selected Developing Asian Economies", *Quarterly Review*, Federal Reserve Bank of New York, Vol. 14, No. 4, Winter 1989-90, p. 39.
19. See, for example, Linda Lim and Pang Eng Fong, *Foreign Direct Investment and Industrialisation in Malaysia, Singapore, Taiwan and Thailand* (OECD Development Centre, Paris, 1991). The role of US investment in electronics in Singapore is also described in George Abraham, "Foreign Direct Investment in Singapore", *Foreign Direct Investment in the Asian and Pacific Region* (Asian Development Bank, Manila, 1988).
20. The exact figure is difficult to determine because of the different classifications used in various US government reports.
21. Louis T. Wells, Jr., *Third World Multinationals* (The MIT Press, Cambridge, 1983).
22. *The Economist* (15 June 1991, p. 44) reports "more than 80 Korean plants in Central America", and "fresh interest" on the part of Korean and Taiwanese (and Japanese) investors throughout Central America.

23. The influence of existing investments on location is well described in Douglas and Wind, *op. cit.*
24. See, for example, Peter F. Drucker, "The Changed World Economy", *The McKinsey Quarterly*, Autumn 1986, pp. 2-26, reprinted in Wortzel and Wortzel, *op. cit.*; and Yves Doz, "International Industries: Fragmentation vs. Globalization", in Bruce K. Guile and Harvey Brooke, eds., *Technology and Global Industry* (National Academy Press, Washington, 1987), pp. 96-118, reprinted in Wortzel and Wortzel, *op. cit.*
25. See Douglas and Wind, *op. cit.*
26. Douglas and Wind, *op. cit.*
27. The basic issues were described by Jay R. Galbraith, *Designing Complex Organizations* (Addison-Wesley, Reading, MA, 1973). For application of some of the ideas to multinational firms, see, for example, C. Antonelli, "Multinational Firms, International Trade, and International Telecommunications", *Information Economics and Policy*, Vol. 1, No. 4, 1984, pp. 333-343; P.J. Buckley, "The Limits of Explanation: Testing the Internalization Theory of the Multinational Enterprise", *Journal of International Business Studies*, Summer 1988; Cray, "Control and Coordination in Multinational Corporations", *Journal of International Business Studies*, Fall 1984, pp. 85-98; Christopher Gopal, "Manufacturing Logistics Systems for a Competitive Global Strategy", *Information Strategy: The Executive's Journal*, Fall 1986, pp. 19-24, reprinted in Wortzel and Wortzel.
28. Christopher Bartlett and Sumantra Ghoshal, "Organising for Worldwide Effectiveness: The Transnational Solution", *California Management Review*, Vol. 31, No. 1, 1988.
29. David Levy, a doctoral candidate at Harvard Business School, is beginning field research on a dissertation that promises to provide some figures for these costs for a limited sample of products and plants.
30. See, for example, Yves Doz and C.K. Prahalad, "Headquarters Influence and Strategic Control in Multinational Corporations", *Sloan Management Review*, Vol. 23, No. 1, 1980; and Prahalad and Doz, "An Approach to Strategic Control in Multinational Corporations", *Sloan Management Review*, Vol. 22, No. 4, 1981, pp. 5-13.
31. Stopford and Wells, *op. cit.*
32. See some of the literature in the previous two notes, and William G. Egelhoff, "Strategy and Structure in Multinational Corporations: An Information Processing Approach", *Administrative Sciences Quarterly*, Vol. 27, No. 3, pp. 435-458.
33. Allen J. Morrison, David A. Ricks and Kendall Roth, "Globalisation versus Regionalisation: Which Way for the Multinationals?", *Organisational*

- Dynamics*, Winter 1991, Vol 19, No. 3, pp. 17-29. These authors also cite the Conference Board, "Building Global Teamwork for Growth and Survival", Research Bulletin No. 228, 1989, p. 13, for evidence that firms are shifting from global to regional strategies, finding their "global businesses too cumbersome or insensitive to specific market needs".
34. See Bartlett and Ghoshal, *op. cit.*
 35. See Dieter Ernst, "Global Competition, New Information Technologies and International Technology Diffusion — Implications for Industrial Latecomers", paper prepared for the Conference on Technology and Competitiveness, OECD, Paris, 24-27 June 1990, p. 12.
 36. F.T. Knickerbocker, *Oligopolistic Reaction and Multinational Enterprises* (Harvard Business School, Boston, 1973), and E. Montgomery Graham, "Oligopolistic Imitation and European Direct Investment in the United States" (D.B.A. dissertation, Harvard Business School, 1974).
 37. See, for example, C. Oman *et al.*, *New Forms of International Investment in Developing Country Industries: Mining, Petrochemicals, Automobiles, Textiles, Food*, OECD Development Centre, Paris, 1989.
 38. The past performance of US multinationals in this respect is explored in John H. Dunning, "European Integration and Transatlantic Foreign Direct Investment: The Record Reassessed", Discussion Paper in International Investment and Business Studies, University of Reading, Department of Economics, Series B, Vol. III, 1990/921, No. 144.
 39. For the opportunities and risks, see Daniel A. Sharp and Jan V. Dauman, "Euro-pessimism or Euro-phobia? U.S. Corporate Response to 1992", *European Business Journal*, Vol. 1, No. 3, 1989, pp. 29-40.
 40. Refer to "Free-Trade Talks Are Seen with Mexico", *New York Times*, 12 June 1990, p. D6.
 41. Harry Freeman, "Free Trade", letter to *The Economist*, 4 May 1991, pp. 6 and 7.
 42. Tariff items 9802.00.60 and 9802.00.80 subsequent to international harmonisation in 1989.
 43. See, for example, R. Lawrence, *Scenarios for the World Trading System and Their Implications for Developing Countries*; S.T. Han, *The Impact of European Economic Integration on the Newly Industrialising Economies of Asia, with Reference to Korea*; S. Page, *Some Implications of Europe 1992 for Developing Countries*; A. Fishlow and S. Haggard, *The United States and the Regionalisation of the World Economy*; W. Fritsch, *Latin America in a Changing Global Environment*, and other Technical Papers produced in conjunction with the Centre's research on globalisation and regionalisation.

Table 1

DESTINATION OF EXPORTS OF US MANUFACTURING AFFILIATES ABROAD
(millions of dollars)
1989

Location of Affiliate	Destination of exports			
	Western Hemisphere	Europe	Asia/Pacific	Total Exports
Canada	34 455	1 455	1 331	37 387
Europe	18 176	87 741	4 974	114 771
Japan	1 991	396	1 347	3 743
Latin America	8 717	854	490	10 176
Other Asia/Pacific	9 605	1 821	5 579	17 483
Total of above				167 820

Source: *U.S. Direct Investment Abroad: 1989 Benchmark Survey, Preliminary Results* (US Department of Commerce, Washington, D.C., November 1991), Tables 42 and 45.
 Only majority-owned affiliates are reported.

Table 2

**PERCENTAGES OF EXPORTS OF US MANUFACTURING AFFILIATES ABROAD
DESTINED FOR THE AFFILIATE'S REGION
1989**

Location of affiliate	Percentage of affiliate's exports destined for affiliate's region
Canada	92%
Europe	76%
Japan	35%
Latin America	86%
Other Asia/Pacific	31%

Source: Calculated from previous table.

Table 3

**PERCENTAGES OF EXPORTS OF US MANUFACTURING AFFILIATES ABROAD
DESTINED FOR THE AFFILIATE'S REGION
1982**

Location of affiliate	Percentage of affiliate's exports destined for affiliate's region
Canada	89%
Europe	79%
Japan	06%
Australia/New Zealand/South Africa	40%
Latin America	81%
Other Asia/Pacific	21%

Source: Calculated from *U.S. Direct Investment Abroad: 1982 Benchmark Survey Data* (US Department of Commerce, Washington, D.C., December 1985), pp. 132 and 231.

Table 4

**PERCENTAGE OF TOTAL VEHICLES BUILT BY PLACE OF ASSEMBLY
1988**

Nationality of manufacturer	Place of final assembly		
	Home country	Local region	Other regions
US ⁽¹⁾	59	12	29
European ⁽²⁾	68	23	9
Japanese ⁽³⁾	76	8	15

Source: Calculated from data reported in Comité des Constructeurs Français d'Automobiles, *Répertoire Mondial*, Paris, December 1989.

- (1) Average for two manufacturers.
- (2) Average for four manufacturers.
- (3) Average for five manufacturers.