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The Strategic Relation Between International Trade & Internationalization FDI: Incentives & Strategy Effects & Risk Management

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- The FDI Importance. Trend & Pitfalls. Determinants and Effects. (Collegio Carlo Alberto- Moncalieri il 22 Novembre 2007)

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The thesis Construction

Introduction:

It was to me a strong challenge with a huge curiousity at the same time, to biuld a good knowledge about how the trade works, and how is it changing? And in what direction? And what are the rules in this game? And what is the effect in this game? especially in a world which has shrinked as the result of the use of instruments of the technical revolutions, and each action has a reaction for short and long time all over the world.

According to the bureau of statistics in the United States the 64000 multinational Companies are resposabile of more than 70 % of the total amount of FDI, and according to the World Investment Bank annual report 2007, more than 80% from FDI is between the trio USA – EU – Japan. The international trade is equal to 18 % from the total GDP and the USA GDP is equal to 5% to world GDP. Knowing the relation between GDP and uneployment(GDP Gap and Okun's Law**). How** the international trade rules connect each country to others, with positive or negative effects? even if each country try to have the same Economic goals, which are: Economic Growth; Full Employment; Economic Efficiency; Price-Level Stability; Economic Freedom; Equitable Distribution; Economic Security and Balance of Trade; at the same time the companies use the Internationalization

to take its advantages, whetwer Profitability ROI = net profits/total invested capital, Profit growth = percentage increase in net profits overtime, Higher ROI and profit growth → Increase in value of an enterprise → higher returns for shareholders and the profit growth can be increased by Selling more to existing markets and Entering new markets, profitability can be increased by Lowering costs and Adding value → increasing prices, and Internationalization can do both! Increased sales and profits and more like chance to enter rapidly growing markets, reduced costs, gaining a foothold in economic unions, protecting domestic & foreign markets, acquiring technological and managerial know-how, secure resources,For this importance I started this thesis in the internationalization theory in the chapter one.

In chapter two I enter the trade and international trade theory, trade policy effect, trade agreement importance, begining with this question: " Why Trade, inside the country and outside? and how the old trade theory depends substantially on the production theory and production factors? And how can we explain the international trade between south and nord countries as Hecsher – Oline Model, can explain the trade between developed and developing countries, going to the new Trade theory and the Multinational companiy rules up to Krugman Model which can explain the trade intra industry and between the developed countries, in new rules as economic of scale, Market structure, game theory, with this Model we can explain the Trade between USA and Europe and Japan, to arrive to the government rules as a policy makers, by using the different effects on trade movment, for example to push the import or the export trade.
At the end I explain the international trade agreement and its effect on the country groups.

In Chapter three going into the internationalization, we should explain the FDI management, advantages and effects, and why the firms select this type when going in a new market.

In Chapter four I explain why the Middle- East and Nord Africa (MENA) are considered potential markets, analysing who are the players there and what are the sectors which are considered the most interesting? looking to the opportunities and avoiding the pitfalls, and explaining how the Textile and clothing sectors work, international and in EURO- MED Area.

In Chapter five I explain some Emirical models which are used by researchers, and what are the main variables, inside their Models and what are the results, and I expalain particularly the Gravity Model and its application on EURO – MED Area, and Euro-CEECs trade.

In Chapter six I present the Dynamic FDI Inflow and Outflow Model, and what is the statistic technique which was used, and how we built the variables, and what kind of results we can obtain? and how the companies can use these results, during their research on a new market as an important step on the Internationalization.

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Finally, my special thanks go to my family for their support and understanding.
I am fully responsible for all the mistakes and errors found in this thesis.

CHAPTER 1

1.1 Internationalization Theory
1.2 Introduction

In recent decades, the global business environment has been growing dramatically. We are living in a more-than-ever-interdependent world. Many firms involve in the process of internationalisation, engaging their operations outside the boundary of their home country. The level of involvement of firms in international process can be specified by different types of foreign market entry modes ranging from import/export, contractual and investment entry modes. Import and export entry modes are the traditional form of international activities of firms. International licensing and franchising are the example of contractual entry modes.

Firms can undergo international operations by investment entry modes. These entail joint ventures, consisting of contractual operations, equity joint-venture and strategic alliance, and sole ventures or the establishment of a wholly owned subsidiary

The advanced technological change, trade liberalisation and intensified international competition are the factors that facilitate and drive such process of economic activities. Yet, it is not sufficient to explain the reason why firms decide to operate their activities abroad. As the business environment has increased in uncertainty and complexity, firms must immediately recognise the critical changes and respond to them rapidly to survive in the industry. It is generally accepted that the first and the most important motive of the businesses in the capitalism economy is the profit maximisation by either increasing the revenue or decreasing the cost of production. In the face of an globally increasing competition, firms not only compete with the rivals in home countries but also the international competitors. Therefore, the pursuit of global profit becomes the key motive of the enterprises (Dicken; 1992). Every activity of the firms, including the expansion of their activities across border, is aimed at increasing or protecting the profits. The sheer variety of competing explanations derived from different theories and motivations have been advanced to explain the internationalisation of businesses.

The transition of social relation also emerges along the processes of internationalisation of business. In an era of globalisation, it is possible to say that the process of internationalisation of the commerce and industry has an implication for political power of nation state. Clearly, historical evidences suggest that it substantially affects the world political landscape. Particularly, the proliferation of the worldwide-basis operation of MNCs in the past two decades requires us to rethink the traditional thought of the relationship between the governments of the nation states and the firms.

The purpose of this chapter is to investigate some explanatory frameworks and motivations to explain the process of internationalisation of the firms. Then to examine the consequence of such development of the political power of the nation states.

1.3 The Motives of Internationalisation of Firms

The origins of the internationalisation of the commerce and industry can be traced by both macroeconomics approach, regarded as a general-system approach which is focused on the capitalist system as a whole, and microeconomics approach, based upon a firm-specific level. In a macroeconomics approach, the expansion of firms' activities beyond their home countries can be explained by the circuits of capital and the theory of new international division of labour. A microeconomics approach entails the Dunning's eclectic paradigm and the theory of product life cycle.

1.4 The Macroeconomics Approach

1.4.1- The New International Division of Labour Concept

The new international division of labour, first proposed by Stephen Hymer, is used to explain the shift of industrial production from the core, the industrialised countries, to the periphery, the developing countries. Firms in developed countries facing increasing wage in their home countries are forced to seek the alternative locations, which are the third world countries, providing cheap labour. Dicken (1992) points out that even though this concept has some validity in explanation of internationalisation process, it also contains several drawbacks. Firstly, it is excessively narrow and one-dimensional. In other words, it oversimplifies the variety of strategic options available to firms. Secondly, it overstates the extent to which industrial production has been relocated to the global periphery.

1.4.2 - The Circuits of Capital Concept

The circuits of capital concept are based on the capital system as a whole. As quoted 'this capitalist world must be subject as a whole to the laws of motion of capitalism… international firms must be understood in term of the internationalisation of capital and the accumulation of capital' (Radice; 1975). The idea behind this concept is to increase profits and accumulate capital by extracting surplus value from the production process as a continuous circuit.

1.5 -The Microeconomics Approach

1.5.1- ECLECTIC PARADIGM

First articulated by John Dunning in 1976, the eclectic paradigm of international production is derived from various theoretical approaches such as theory of firm, trade theory, organisation theory and location theory. It attempts to integrate three general and interrelated concepts to identify and evaluate the significance of factors influencing both the initial act of cross-border production by firms and the growth of such production.

Within the increasing competitive pressure on firms to sustain or increase profits, the eclectic paradigm avers that at any given moment of time, the extent and pattern of international production can be determined by a set of three factors which are *ownership-specific advantage, internalisation advantage* and *location-specific advantage.* Each factor will be discussed in turn.

1.5.1.1 .Ownership-Specific Advantages

They arise when a firm of one nationality possesses certain specific advantage over the competing firm of other nationalities. They are internal assets which are not available to other firms. These include those created by the firm itself, such as knowledge, organisational and human skill, purchased form other institutions, taken the form of a legally protected right or of a commercial monopoly, and those of size, diversity or technical characteristics of firms (Dunning; 1980). Stephen Hymer first states that outbound activities could occur only if the firm possesses a particular advantage over the local firms to compensate for the lack of the understanding of the local market environment.

1.5.1.2.- Internalisation Advantages

These advantages arise when a firm internalises the use of its ownership-specific advantage. To this extent, the firm perceives it to be in its best interest to exploit its ownership-specific advantage rather than sell them or the right to use them to foreign firms. According to Dicken (1992), the key incentives for firm to internalise market are market imperfection and uncertainty. The greater degree of market imperfection and uncertainty, the greater the incentive and advantage for firm to perform the function of the market itself by internalising the market transactions. Internalisation is especially likely to occur in the case of knowledge and technology because they contain public-goods characteristics which is easily transmitted across the country boundary. Because of huge amount of money spent on R&D, firm will have incentive to retain technology and exploit it directly on the world-wide basis rather than sell or lease it to foreign firms.

1.5.1.3- Location-Specific Advantages

This factor affects the decision of the location of production. To this extent, firm finds that it must be more profitable to exploit its assets in overseas location rather than domestic location. Dunning defines location-specific factors as 'those which are available, on the same terms, to all firms whatever their size and nationality, but which are specific in origin to particular locations and have to be used in those locations'. As classified by Dicken, there are several major types of location-specific advantages which will be identified in turn.

- *Variations in Size and Nature of the Market*: The global market exhibits an enormous variation in income level, an approximate measure of market size, suggesting the difference in magnitude and nature of consumption patterns across countries.

The Political and Cultural Dimension: This includes political climate, government policies, trade policies, national attitude, language and culture. It has been accepted that the important source of market imperfection is the government interventions. For this reason, government policies significantly affect the pattern of international production. The historical evidences also suggest that many overseas investments occur in the countries of similar culture and language.

- *Variation in Production Costs:* The spatial variation in production costs, especially in labour factor, has contributed significantly to the shape of international production in the worldwide basis. To the context of different labour factor across countries, several aspects of variation are in presence. These are geographical variation in wage cost, labour productivity, degree of labour controllability, and mobility of labour. Dicken (1992) points out that one way to handle the uncertainty of future production cost in different locations is to locate similar activities in the various different locations and adopt a flexible system of production allocations between locations.

According to the paradigm, firms will involve in international production if and only if these all three conditions are satisfied. The configuration of ownership, location and internalisation (OLI) advantages and disadvantages determine the structure, nature and strategy of the firm. The merit of this paradigm is that it incorporates a major characteristic of the diversity of transnational investment in the global economy (Dicken; 1992). Yet, Taylor and Thrift (1986) contend that this paradigm is merely 'a list of factors likely to be important in the explanation of the modern… (Transnational corporations)… rather than the explanation itself. Theoretical relations between the different factors too often remain untheorised'.

1.6 - THE PRODUCT-LIFE-CYCLE THEORY

The product life cycle theory, first articulated by Professor Raymond Vernon in 1966, was developed to explain the locational tendencies for each phase of the product cycle-particular the US MNCs.

In the beginning of the cycle, the production facilities take place in the home country (the US) with high income and labour costs. The products are exported to overseas markets. To increase the competitiveness and reduce the production costs, firms start moving the production activities to the other developed markets. In the last stage, within the intense competition in standardised products, firms are forced to move their production facilities to exploit the relatively cheap labours in the developing countries. To this extent, the developed countries become net importers whereas the developing countries become net exporters.

Dicken (1992) points out that this model has its own merit in such a way that it is an ideal-type model which sheds the light on the dynamic nature of the processes. However, some authors and even Vernon himself began to cast some doubts that the model is losing some of its relevance as the explanation of international investment. Giddy (1978) stated that 'as an explanation of international business behaviour, the product cycle model has only limited explanatory power…..The multinational enterprise, however, has succeeded in developing a number of other strategies for surviving in overseas production and marketing. Hence, the product cycle model must now take its place as only one facet of the more general phenomenon of large international firms successfully applying a diversity of monopolistic advantages across national boundaries in order to internalise imperfectly competitive factor markets'. Dicken (1992) also criticises that the model can no longer explain the international investment pattern by the MNCs. Firstly, it explains merely a general sequence but it fails to provide the length of each stage and the timing of the transition from one stage to another. Secondly, as being in the more complex and uncertain global environment, it is unwise to assume evolutionary sequence from home country to

foreign country. Rather, the initial source of innovation and production may be from any point in global network of the firm. Thirdly, it fails to explain the fact that much of international investment occurs between advanced industrial countries. At last, he points out that the application to real-world circumstance must be time- and place-specific.

However, the product-life-cycle theory still has significant power for explanation of internationalisation process of firms. Carnoy (1996) points out that "The equalisation of labour costs and income per capita among the developed countries has not altered the power of product-cycle theory to explain the location of multinational production and R&D: the theory predicts that new product development will spread, and it has".

So far, the preceding theories have been advanced to explain the motivation of the internationalisation of the firms. In general, it can be said that companies are attracted to cross-border activities because of the dynamic of and interaction between external and internal factors. In fact, internationalisation results from a combination of factors rather a single factor. Both kind of factors not only provide the explanation of cross-border activities of firms but also shed the light of organisations' strategic response (Ellis and Williams; 1995).

1.6.1- The external factors which are influential in internationalisation process are described by the factors outside the control of the firms. In other words, they represent the opportunities and threats of the firm. Ellis and Williams (1995) classify external factors into three level; Meta level, industry level and firm-specific level. Meta level factors are concerned with the changes in the broad environment including political, economic, ecological, social, and technological factors. Industry-level factor is competitive forces within the industry. Firm-specific factors involve either a merger/take-over resulting in change in ownership or shareholder pressure.

1.6. 2- Internal factors deal with the change within the organisation and vision of the firms' executives i.e. risk aversion of the decision makers of the companies. To put it more simply, they are strengths and weaknesses of the firm. According to Ellis and Williams (1995), they embrace organisational crisis, management succession, business performance and internal dissent. They also point out that the importance of the internal context is substantially affected by the culture of the company. This proposition explains why different companies respond differently to the same external stimulus.

As indicated earlier, the international expansion of firms' activities has to be seen within the context of the firms' attempts to maintain or increase their profit in an increasingly competitive, complex and uncertain global environment. To this extent, the reasons of cross-border expansion may be regarded as either defensive or aggressive or a combination of both**.**

1.6. 3- The defensive or reactive reasons are considered the push factors that drive firms to engage crossing national borders when firms perceive some difficulties in their business performances and try to maintain their profitability and competitive position in the markets. These difficulties include decreasing profits, market saturation in home or existing market, increasing costs of production and government regulations, and fierce competition.

Conversely, the **aggressive or proactive reasons** are regarded as the pull factors that entice firms to move into foreign boundaries. They arise out of realised attractiveness and

profitability of cross-border operations. These include the attractiveness in potential new-open markets, cheaper operating costs, and favourable incentive offered by host government.

According to Dunning (1994), the motives of cross-border operations of firms can be divided into four groups. Firstly, companies decide to internationally disperse their operations because of the **resource related** factors. In this respect, the availability of cheaper resources and security of supply sources can be powerful incentives to drive firms to invest abroad. These resources include labour force, natural resources and managerial and technological skills. The second group of factors are **market related**. The traditional way to attract FDI is to impose trade barriers on the imports. The more recent instrument is to offer the most favourable incentive to attract FDI. The market related motives can be aimed at protecting existing markets (defensive) or exploiting new markets (aggressive). Firms may have to follow their customers and suppliers abroad to sustain the business. To prevent themselves from being left behind, firms want to set a foothold in the markets that their competitors are already there or going to enter the markets. MNCs are also attracted by country-specific attractiveness such as large, increasing-grow markets. Thirdly, firms are motivated by **strategy related** factors. The international operations may be part of the global strategy to increase the global awareness of products and build up a global brand. Being international entity creates good image, prestige and power to the company and in turn boosts sales in home and host countries. Further, companies acquire the assets of foreign firms to pursue their long-term strategic objectives. Forth are **efficiency related** factors. Companies involve in beyond-border activities in order to benefit from economies of scope and scale and risk diversification. Investing in several countries can help diversify and reduce risks.

1.7 -Some trends in market entry mode theory (Dunning)

1.7.1 -A general or complete entry mode decision making model

Most of the existing literature focuses on the exploration of those factors which influence the market entry mode decision and on the investigation of their impact on this decision. These studies mostly result in a partial behavior analysis (Dunning 1988). Being specific to some certain context and time period the cognitions of partial behavior analysis are limited and difficult to generalize. Restricting to selected factors may easily lead to wrong or inconsistent conclusions, just like one who touches only the leg of an elephant and claims that an elephant looks like a tree. This might also explain the above mentioned conflicting results. So, more general business strategy models are needed to analyze the market entry mode choice and to explain the genesis of corresponding decisions. Such a “general” or “complete” model should engage in at least individual, organizational, as well as institutional or societal level of analysis on their respective impacts on entry mode choice decision. Why so? Since entry mode choice is made directly by owners and/or managers, individually or cooperatively. Individuals’ behavior and decision making are influenced and restricted by their preferences, their incomplete rationality (due to inadequate information, limited computational skills, as well as uncertainty), the defined roles provided by the organization, as well as the contingent environment around them. As argued by Evan (1993) organizational strategy, organizational structure and environment are in close relationship; good matching between environment and organizational strategy and structure is positively related to performance. Organizational behavior and individual decisions shape mirror the environment, and the environment affects individual as well as organizational decision and behavior.

1.7.2 -A dynamic or rather longitudinal entry mode decision making model

We could detect that market entry mode choice was primarily regarded as a one-stage or a static decision making problem, primarily evaluated by the outcome of market entry mode decisions. But in fact in many cases it is a multiple-stage problem which involves at least a process of goal formulation, alternative strategies identification, and optimal or suboptimal strategy selection. A dynamic choice model which is more ambitious to emphasize cognitive processes in decision making involves a hierarchy of single decisions, each of which being an attempt to improve the outcome in the light of new information gained in previous decisions.
Thus it provides a more realistic description of human problem solving than a static one does. Furthermore, firms having started to enter into a foreign market may change their original strategy due to learning effects or unscheduled developments. So, dynamic models which additionally consider longitudinal aspects are desirable to fully understand foreign market entry mode decisions. Some researchers, such as Pan et al. (2000), have realized this trend and tried some attempts but it still deserves more attention in future research.

1.7. 3 - Comparative studies

Market entry mode decision has been studied primarily as a profit maximization problem of industrial or non-industrial organizations (such as banks and hotels) which exist for profit and growth. However some non-industrial organizations, such as public universities or chambers of commerce, do not primarily exist for profit, expansion or growth. Market entry mode decisions of such organizations are normally not driven by profit maximization.

The differences in entry mode decision making of profit and non-profit oriented organizations are worth to be investigated in depth. Furthermore market entry mode decisions might differ from time period to time period due to varying macro or micro contexts. Hence, intertemporal studies on this problem may induce a more precise understanding of market entry mode theory. To our knowledge there are few existing papers studying market entry mode choice from these two aspects.

1.7.4 -A multi-objective problem

Besides profit maximization there are also some other goals, such as network building or information gathering, that may drive the market entry mode decisions of industrial organizations.
These goals might be of conflicting nature and might have different priorities for the respective decision. So, if we redefine the problem by taking into account other or rather more objectives of foreign market entry we have to solve it in a quite new way. Recently Hajidimitriou et al. (2003) constructed a goal programming model to solve entry mode choice as a multi-objective problem. Future research might focus on solving this multi-objective problem by means of alternative economic tools.

The fundamental point to be appreciated is that most MNCs' motives of going abroad are identified by several reasons rather than a single motive. Internationalisation process may be characterised in term of defensive or aggressive and motivated by either internal or external triggers or a combination of both. For given firm, these factors can change over time for each circumstance and stage of development of firms. However, as mentioned earlier, the principal objective of firms is long-term profit maximisation. It appears that the

process of internationalisation is a rational decision-making activity (Ellis and Williams; 1995). Therefore, to justify any cross-border activities, the expected benefits must outweigh the costs or risk of such activities.

Operating the business beyond home-country boundary inevitably involves costs or risk such as exchange rate exposure, country risk, and any other risks that may arise from cross-border operations. Clearly, these risks results from complex and uncertain environment. The risks involved can be either systematic (undiversifiable) or unsystematic (diversifiable) risks. The diversifiable risk such as exchange rate exposure can be managed by the so-called hedging. The country risk regarded as systematic risk can also be reduced via insurance.

1.8 - Consequences of Internationalisation of Firms for Political Power of States

The rapid growth of degree of interdependence in international political economy require us to reassess the landscape of contemporary world. The processes result in a new economic, political and cultural transition. The internationalisation of the commerce and industry is the starting point of the huge empire of the MNCs. In fact, MNCs are one of the vehicles for increasing global interdependence. To date, these giant corporations exert a pervasive influence over the particular countries. Their global operations contribute a lion share of world trade and production. The dominant and expanding economic and political power of these MNCs is a result of their firm-specific advantage which is the capacity to pool the resources through the financial resources and established worldwide network. The advanced technology and better managerial practices also give the MNCs a worldwide specific advantage.

As their increasing economic power corresponds to the growing social and political influence over the other state, the relationship between the MNCs and host countries is a primary site of debate in the past two decades. It is argued that the national governments loss their power to control and impose any constraint toward the MNCs due to the increasing power of the MNCs. Clearly, in the battlefield between MNCs and host countries, there is a conflict of interests leading to an uneasy relationship between them. This is because they pursue different objectives. The MNCs, like any business enterprise, want to maximise the corporate profits regardless the interests of any particular country. In contrast, nation states want to achieve their national goals of promoting economic growth and welfare for national citizen. As the world economy is dominated by multinational capital, the challenge has been posed to the nation states' ability to regulate the MNCs operating in their territory. Thanks to their high efficiency of the worldwide operations, the MNCs can easily escape the regulations imposed by the national governments. Given the internationalisation of capital through the MNCs' operations, it is argued that this might be the end of the sovereignty of the nation state. Yet, as we will discuss later on, it might not be necessarily the case.

In the early day, the MNCs' expansion was dominated by American MNCs. Consequently, the Western European and Japanese counterparts follow the American's footstep. As a result, today, most of the leading MNCs are from the Triad area. The proliferation of Triad's MNCs is equivalent to the expansion of the political power of these nations.

The existence of these large corporations with international monopoly power undoubtedly has an effect on the redistribution of power on the global basis. The national governments are competing with each other, by offering the most favourable incentive such as grant, subsidy, unlimited repatriation of profits and favourable taxation, to attract FDI because they hope to use the MNCs' operations as an engine for promoting their economic growth. The FDI is expected to bring a host of benefits to the host countries. These include increasing local production, increasing the demand for local inputs, a wider range of goods at lower prices. Further, the MNCs give the contribution to capital inflows, exports, supply of foreign exchange, improvement of balance of payment, transfer of managerial skills and technological capabilities to local producers, and employment creation.

Despite the positive roles of the MNCs, the capital inflow of FDI from MNCs also induce costs to host countries. The issues of a lack of commitment, uneven development, dependency, screwdriver plants, environmental degradation and transfer pricing have been big concerns for the host countries. The MNCs spend a lot of time and resources on R&D to acquire new technology and then rarely willing to transfer the technology and skill to the local managers and entrepreneurs. Therefore, not much will be left behind when they decide to shut down the activities in host countries. The existence of MNCs also discourages the locals to acquire and build up their own technology and capacity. This is nothing but economic and technological dependency. Further, It is unlikely that the MNCs will place the highest-return and highest-level activities in foreign country (Carnoy; 1996). The investment in recipient countries, particularly in the third world countries, can only be a assembly base or so-called screwdriver plant. In addition, the national governments are aware of the exploitation of the indigenous resources resulting in environmental damage. Even though FDI creates employment, it can also create unemployment when MNCs drive out the small indigenous business, causing a net loss of employment. The increasing monopolistic power may finally lead to the higher local prices. The inter-firm trade, the cross-border transactions between subsidiaries of the same corporation, has been a significant growth in contribution to world trade. This intra-firm trade is manipulated and conducted on the transfer price basis, rather than an arm's length basis. By bypassing the market and setting up their own prices, the MNCs then can escape taxes and transfer the profits back home. MNCs also have little commitments to the recipient countries. Further, the capital inflows and exports created by FDI may be offset by larger foreign exchange outflows through imports of components, repatriated profits and licence and franchising fee.

The question is how to distribute the benefits and costs of MNC activities between two parties. Form the hosts' standpoint, they try to maximise the value added, created by the operation of the MNCs. In this respect, it largely depends on the relative bargaining power between two parties.

A single national market now seems to be self-insufficient to satisfy the economic requirements of its citizens. Nation state's control over its own economic affairs will give away to these international corporations that better suited the economic needs of people. The cost of inefficiency of the assertion of national sovereignty in order to achieve national goals would be too high. It is argued that national economic goal can only be achieved through participation in the world economy.

Given the advantages brought to host countries, no government would shut out the MNCs and thereby forgo benefits these corporations bring to countries. Up to this point, they seem to be more powerful than host governments as governments become incapable of legally controlling the activities and policies of MNCs. Then, they lose control over internal economic affairs. Can state retain its independence and sovereignty and simultaneously meet the expanding economic needs of its citizens? Unfortunately, it seems that the bargaining advantages are on the side of MNCs.

The attractiveness of host countries to MNCs depends on the local economic conditions. The countries will be in a better bargaining power if they have potential large markets, natural resources and high-skill, low-cost and trainable or well-trained local labour, and good communication systems and infrastructures. Similarly, the MNCs with high firm-specific advantages and high potential contribution are in a better position. Yet, the terms may be re-negotiated as the bargaining position is changing over time depending on the continued attractiveness of the host countries and the MNCs.

The intensifying competitive bidding of prospective host for FDI will increase the bargaining power of the MNCs. It is argued that once the plants are set up in host country, the national government will gain an upper hand. This might not be the case. According to the footloose character of the MNCs and the shorten product life cycle, they can move to a more favourable country once the existing host country can no longer provide the acceptable condition for their business development. The freedom of host countries to regulate MNCs is not only restricted by the footloose ability of MNCs but also by the policies implemented by home countries' governments. That is, MNCs can lobby their home governments to put the pressures on the host countries on their behalf.

Nothing gives a better picture than the case of Japanese government, as pointed out by Dunning (1994). In earlier times, Japan pursued a restrictive policy towards the FDI. By doing so, governments decided to forgo the short-term benefits form FDI for long-term benefits. As a result of substantial investment in training, education, and technology, Japan now can welcome the FDI into the country without any fear of losing the autonomy.

The benefits enjoyed by MNCs, however, has been challenged by the rise of the economic nationalism. Governments try to get greater local control through joint venture, nationalisation, etc. National governments increasingly make MNCs serve local interests and prevent themselves not to be exploited by the big foreign company as they used to be.

The regulations toward the FDI and MNCs appear in various guises and can change over time depending upon the relative bargaining power we discussed earlier. Host governments may pose the regulations to increase local equity participation or specify the sectors or types of activities which are of importance in economic development. Often, the MNCs are forced to locate their activities in high unemployment area. To avoid being screwdriver plants, governments may implement the regulations to increase local value added. These include imposing trade barriers on the imports of components to encourage firms to buy locally and specifying the minimum amount or certain percentage of local value added. Host governments are increasingly aware of revenue leakage due to transfer pricing. They try to control such practices by encouraging arm's-length-basis transactions.

However, in an era of perceived powerful MNCs, the national unilateral regulation is no longer adequate. It appears that the multilateral or international regulatory framework

might be the more effective way to control and regulate the behaviour of the MNCs. Countries realised that the collective actions by group of countries are far more effective than going-alone actions. The international codes of conduct or guidelines of MNC behaviour is one form of the collaborative actions. However, these guidelines are not legally forced. Rather, countries are encouraged to abide by such guidelines. The regional integration in several parts of the world is a clear manifestation of the collective actions towards MNC behaviour. Countries collaborate with each other to harmonise the policies against MNCs and increase their bargaining positions. UNCTC (United Nations Centre of Transnational corporations) was set up to advise and assist governments on how to be in the better bargaining position and gain the most benefits of the presence of FDI. However, the multilateral actions are difficult to enforce in practice. MNCs may ignore the international codes if they are against the interest of the firms. In the light of regional integration, it may be hard to unify and reconcile the interest of countries. The more powerful nations may gain at the expense of the small countries (Dunning; 1994).

It is accepted that both corporations and host governments seek to maximise their economic interest and were well aware of the useful support from each other. The MNCs help promote economic growth of the recipient countries. In return, nation states have a major role in providing well-educated, high-skill labour, sophisticated communication and infrastructure to maximise the operational efficiency of the MNCs.

It follows that nation states still play a major role. In other words, an effective private sector supports, and is supported by, an efficient public sector. In this respect, there is an optimistic view that the MNCs and host government will consider each other with less confrontation and more constructive view to maximise mutual benefits for both parties

1.9 -Concluding Remarks

In the face of globalisation, firms learn to operate their activities with a number of geographically dispersed operations. The internationalisation process of the enterprises is one of the primary sites of attention. Discoveries in telecommunications and computer facilities lessen the costs of cross-border operations and encourage firms to internationally disperse their activities. In today's dynamic world, the geographical boundary between countries becomes irrelevant. Most firms are driven to internationalise their economic activities by global forces. This paper is intended to investigate the determinants and consequences of the processes of internationalisation of business.

It appears that internationalisation is an identifiable evolutionary sequential process. As discussed earlier, firms internalise their economic activities for a host of different motives. The explanation for that can be approached in various ways and levels. Many theories tried to explain such processes. Internationalisation process may be characterised in terms of defensiveness or aggressiveness and motivated by either internal or external triggers or a combination of both. Clearly, there is no universally and single explanation of such expansion across national boundary. Each framework or theory has its own merit and pitfalls. It would be illusive to seek for an all-embracing explanation (Dicken; 1992). Therefore, it is unwise to put any effort to produce a single and clear-cut explanation. In stead, the triggers to the internationalisation process are the dynamic interact of a variety of factors.

To this extent, Dunning (1995) suggests that most behavioural and theoretical explanations do not explicitly identify the motives of the firms, but merely the variables that are likely to influence firms' behaviour. In addition, most explanations involve articulating what firms actually do rather than what they should do.

Furthermore, it is clear that it is no longer the choice for companies to involve in cross-border operation. In stead, firms are forced to undergo internationalisation process and compete globally. It become one of the key strategic decisions for firms to maximise or at least sustain profits to survive in the world of uncertainty and complexity.

The global economic expansion has been largely facilitated by the growth of MNCs. They dominate world trade and capital movement. Some large MNCs have turnover exceeding the GNP of some countries. These corporations continue to grow and influence the landscape of the world economy.

The main concern is not only the economic consequences but also the political and social outcomes of MNC activities. It is argued that high economic power allows the MNCs to gain an upper hand over the host governments by exerting leverage over policy making. They have been accused of exploiting recipient countries, being a cause of uneven development and erosion of the sovereignty of home countries. Therefore, the relationships between host countries and MNCs seem to be contradictory rather than co-operative.

However, it might not be totally justified to claim that the host government lose the control over the multinationals. There has been the rise of economic nationalism and national identity. Being an Economic power and a key actor of re-shaping new world order of the MNCs do not invalidate the roles of the nation states. There is still a role for the nation states in providing a good-quality infrastructure for the MNCs. Clearly, both parties are likely to work together to promote economic welfare for both parties.

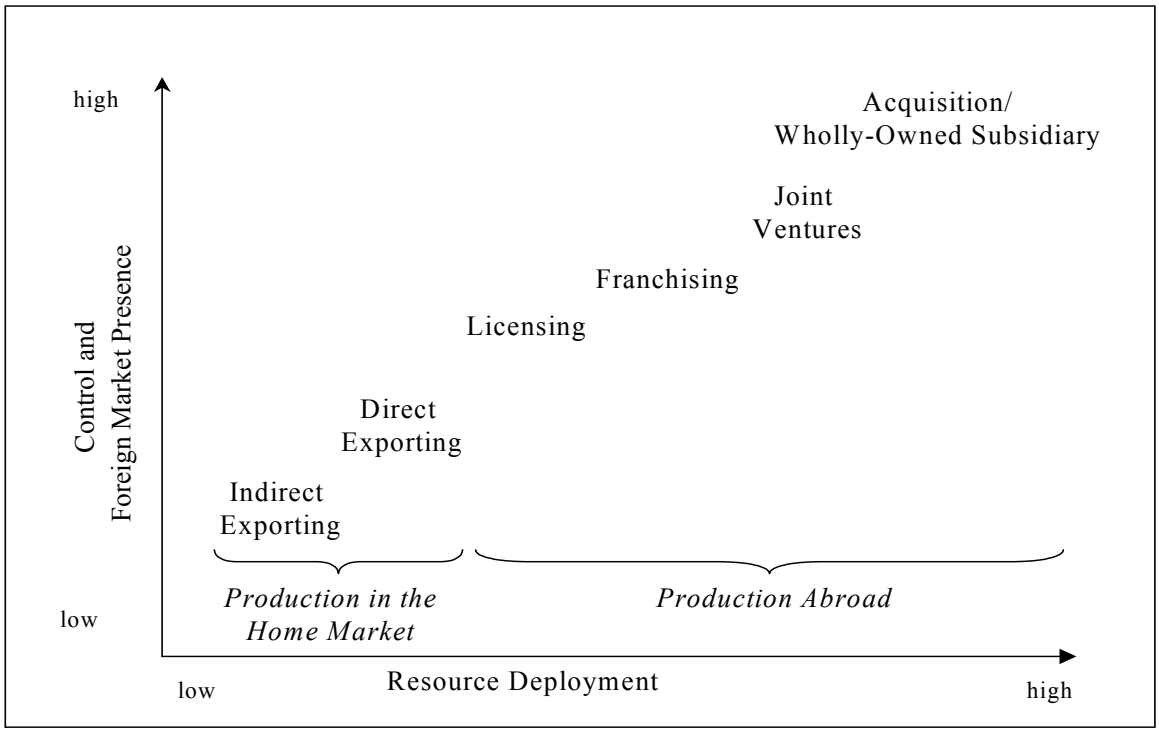
Taken all together, the international political economy has undergone a profound change. Government has to act like a business entity and the business entity has to move toward diplomacy. The thrust of the argument is the conflicting interest between the nation state and the MNCs. The challenge facing the recipient countries is not whether to work with the MNCs or how to regulate and control MNCs but how to maximise the value-added or contribution, created by such activities, to long-run economic growth.

1.10 Entry Mode select

Entry Mode	Advantage	Disadvantage
Wholly owned subsidiaries	▪ Enables global strategic coordination ▪ Protects technology ▪ Realizes (potentially) location and experience economies	▪ High costs and risks ▪ Requires overseas management skills ▪ May be slower to implement
International Joint Ventures	▪ Gives access to local partner's knowledge ▪ Allows sharing of development costs and risks ▪ May be more politically acceptable than 100% foreign ownership ▪ Allows foreign parent do deploy resources across more national markets at once	▪ Loss of control over technology and managerial know-how ▪ May impede global coordination ▪ May make realization of location and experience economies more difficult ▪ Sharing of profit "pie"
International Strategic Alliances	▪ Similar to international joint ventures	▪ May be more difficult to manage than international joint ventures
Franchising	▪ Low financial risk ▪ Relatively low development costs	▪ Lack of direct control over quality ▪ Successful international franchising requires considerable start-up and ongoing presence overseas (cost) ▪ Is likely to impede, make global coordination costlier than ownership ▪ Growth may be slower depending on franchisee's intentions ▪ Sharing of profit "pie" ▪ Possible loss of know-how to potential competitor
Licensing	▪ Similar to franchising ▪ Fewer "maintenance" costs than franchising	▪ Similar to franchising
Exporting	▪ Ability to realize experience curve economies	▪ Transport costs ▪ Trade barriers ▪ Motivation of local agents a challenge

Source: author works.

The control level degree in a new market



Source: Krugman (1998)

CHAPTER 2

FDI Management

2.1 Introduction

Over the past two decades, many countries around the world have experienced substantial growth in their economies, with even faster growth in international transactions, especially in the form of foreign direct investment (FDI). The share of net FDI in world GDP has grown five-fold through the eighties and the nineties, making the causes and consequences of FDI and economic growth a subject of ever-growing interest.
The literature on FDI and economic growth generally points to a positive relationship between the two variables, and offers several, standard explanations for it. In principle, economic growth may induce FDI inflow when FDI is seeking consumer markets, or when growth leads to greater economies of scale and, hence, increased cost efficiency. On the other hand, FDI may affect economic growth, through its impact on capital stock, technology transfer, skill acquisition, or market competition. FDI and growth may also exhibit a negative relationship, particularly if the inflow of FDI leads to increased monopolization of local industries, thus compromising efficiency and growth dynamics

. Empirically, the positive effect of economic growth on FDI and also the positive and negative effects of FDI on economic growth have been identified in the literature. However, very few studies attempt to directly test for causality between FDI and growth. Two studies that do so include Basu, Chakraborty and Reagle (2003), and Trevino and Upadhyaya (2003). Both find that FDI-to-growth causality is more likely to exist in more open economies. In addition, an earlier study by Ericsson and Irandoust (2000) explores the causal relationship between FDI and total factor productivity growth in Norway and Sweden, and finds the two to be causally related in the long run.
The importance of institutions to economic dynamics is now well recognized, and given the widespread but varying institutional reforms across countries through the eighties and the nineties, the inclusion of institutional factors is indispensable for the analysis at hand. To identify their relevance to the FDI-growth relationship, separate from their direct effects on FDI or growth alone, the analysis focuses on interaction effects involving the explanatory variables Growth-to-FDI causality, on the other hand, is reinforced by greater political rights and more limited rule of law.

International trade theory tells us that home-country concerns about the negative economic effects of offshore production may be misplaced. The term **offshore production** refers to FDI undertaken to serve the home market. Far from reducing home-country employment, such FDI may actually stimulate economic growth (and hence employment) in the home country by freeing home-country resources to concentrate on activities where the home country has a comparative advantage. In addition, home-country consumers benefit if the price of the particular product falls as a result of the FDI. Also, if a company were prohibited from making such investments on the grounds of negative employment effects while its international competitors reaped the benefits of low-cost production locations, it would undoubtedly lose market share to its international competitors. Under such a scenario, the adverse long-run economic effects for a country would probably outweigh the relatively minor balance-of-payments and employment effects associated with offshore production.

In this chapter we attempt to respond a more important questions about the FDI and FDI mechanism, like Why is FDI increasing? Why do firms choose FDI over exporting or licensing to enter a foreign market? Why are certain locations attractive for FDI? How does political ideology influence government policy over FDI? From a host or source country perspective, what are FDI's costs and benefits? How can governments restrict/encourage FDI?

The literature on foreign direct investment (FDI) and economic growth generally points to a positive FDI-growth relationship. However, very few studies offer direct tests of causality between the two variables. In theory, economic growth may induce FDI inflow, and FDI may also stimulate economic growth

2.2 Foreign Direct Investment

Multinational companies are made, not born. How a company becomes a multinational is an issue that has drawn a number of researchers to look at the patterns of change over time in a firm's international operations. Two models in particular have been found useful by managers, policy-makers, and academics: Ray Vernon's Product Life Cycle (PLC) theory, and the learning model developed by researchers in Sweden (Johanson & Vahlne, 1977).

2.3 The Product Life Cycle Theory

In 1966, Ray Vernon developed a model built on the internationalization patterns of U.S. firms which dominated overwhelmingly the ranks of MNCs at the time. In the mid-1960s, per capita income in the U.S. was still much higher than in any other major market (it was twice the level of Western Europe, for example), and the U.S. had relatively high labour costs. Vernon postulated that U.S. manufacturers would likely focus on innovations for the high-income consumers of their home market and/or labour-saving products, and that they would be highly likely to produce their new products in their U.S. factories, even if they owned factories abroad in lower-cost locations. Vernon reasoned that with new products, for which the optimum design was still unclear and the price sensitivity of customers relatively low, the home base was "a location in which communication between the markets and the executives directly concerned with the new product is swift and easy, and in which a wide variety of potential types of input that might be needed by the production units are easily come by" (Vernon, 1966: 105-6).

The innovating company, therefore, was likely to produce a new product first in its U.S. home market, for which the product had been originally designed. Over time, the product matured: a dominant design became accepted and production processes stabilized. Meantime, an export market would develop for the product in those markets where certain high-end customers welcomed the innovation and are willing to pay a premium for it. Over time, foreign demand would grow, as foreign markets advanced economically, and exports increased. Eventually, the firm would consider setting up manufacturing in its larger foreign markets. Vernon postulated that most managers are "myopic" -unlikely to incur the costs and uncertainties of moving production outside their home country unless pushed into doing so by a "triggering event" that threatens their export markets, such as the emergence of local competitors trying to move in on the market created in their country by the firm's exports, or the threat of tariffs.

Once established in the larger markets, the offshore production facilities would serve local markets with local production, substituting for exports. The market would expand, since the price of the product would be reduced by local production (lower labour costs, the

elimination of transport costs). Over time, this lower price would encourage the growth of markets in the less developed countries, which might well be served not from the home country factories but from the secondary factories. And as the product becomes standardized, the firm might well set up production in the most rapidly growing less developed countries, where economic growth has created new markets. Eventually, the home country itself is served by products manufactured offshore, either by the firm's own subsidiaries offshore, which take advantage of highly standardized production processes and low labour costs to reduce prices, or by local competitors in the "follower" countries that can emulate the by-now standardized production processes and take advantage of established and increasingly price-sensitive markets in the earlier-developing markets.

While the PLC theory came to be widely accepted as a theory of the migration of industries across locations over time, Vernon himself recognized that its validity as a model of the evolution of the MNC was challenged by the changes in U.S. MNCs in the ensuing decade. By the late 1970s, many of America's leading MNCs had well-established networks of production around the world, and were increasingly likely to introduce new products simultaneously in several markets, rather than beginning at home and rolling out the product internationally over time. One reason for doing so was the closing of the income and labour cost gaps between the U.S. and the other developed countries, especially those in Europe; another reason was the speed at which increasingly capable local companies could emulate (often through reverse engineering) new products (Vernon, 1979). Vernon himself wrote a critique of his own model in 1979, suggesting that it was much less general than he had posited more than a decade earlier. But he suggested that it might well still apply to companies just beginning their international expansion, and for firms whose products involved high levels of experimentation and uncertainty early in the initial production runs. He suggested that it would also apply to firms in the rapidly industrializing countries such as Mexico, Brazil, and Korea, whose innovations, tailored to their home markets, might well find their most promising international markets in "the other developing countries that were lagging a bit behind them in the industrialized pecking order" (Vernon 1979: 266).

2.4 The Theory of Comparative Advantage

The theory of competitive advantage provides a basis for explaining and justifying international trade in a model assumed to enjoy: Free trade. Perfect competition. No uncertainty. Costless information. No government interference.

The features of the theory are as follows; Exporters in Country A sell goods or services to unrelated importers in Country B. Firms in Country A specialize in making products that can be produced relatively efficiently, given Country A's endowment of factors of production (land, labor, capital, and technology). Country B does the same with different products (based on different factors of production, because the factors of production cannot be transported, the benefits of specialization are realized through international trade. The *terms of trade*, the ratio at which quantities of goods are exchanged, shows the benefits of excess production. Neither Country A nor Country B is worse off than before trade, and typically both are better off (albeit perhaps unequally), as long as these ratios are unequal, comparative advantage exists

While total production of goods has increased with the specialization process, international trade at a certain range of prices (containers of shoes for a container of stereo equipment) can be distributed between the countries; this exchange ratio will determine how the larger output is distributed.

Although international trade might have approached the comparative advantage model during the nineteenth century, it certainly does not today; Countries do not appear to specialize only in those products that could be most efficiently produced by that country's particular factors of production, at least two of the factors of production (capital and technology) now flow easily between countries (rather than only indirectly through traded goods and services), Modern factors of production are more numerous than this simple model, comparative advantage shifts over time, comparative advantage is still, however, a relevant theory to explain why particular countries are most suitable for exports of goods and services that support the global supply chain of both MNEs and domestic firms, the comparative advantage of the 21st century, however, is one which is based more on services, and their cross border facilitation by telecommunications and the Internet

2.5 Market Imperfections: A Rationale for the MNE

MNEs strive to take advantage of imperfections in national markets; these imperfections for products translate into market opportunities such as economies of scale, managerial or technological expertise, financial strength and product differentiation, Firms become multinational for one or several of the following reasons:

Market seekers – produce in foreign markets either to satisfy local demand or export to markets other than their own.

Raw material seekers – search for cheaper or more raw materials outside their own market

Production efficiency seekers – produce in countries where one or more of the factors of production are cheaper.

Knowledge seekers – gain access to new technologies or managerial expertise

Political safety seekers – establish operations in countries considered unlikely to expropriate or interfere with private enterprise

2.6 Sustaining & Transferring Competitive Advantage

In deciding whether to invest abroad, management must first determine whether the firm has a sustainable competitive advantage that enables it to compete effectively in the home market, in order to sustain a competitive advantage it must be: Firm-specific. Transferable. Powerful enough to compensate the firm for the extra difficulties of operating abroad. Some of the competitive advantages enjoyed by MNEs are: Economies of scale and scope. Managerial and marketing expertise. Advanced technology. Financial strength. Differentiated products. Competitiveness of the their home market

2.7 The OLI Paradigm & Internationalization

The OLI Paradigm (Buckley & Casson, 1976; Dunning 1977) is an attempt to create an overall framework to explain why MNEs choose FDI rather than serve foreign markets through alternative modes such as licensing, joint ventures, strategic alliances, management contracts and exporting

The paradigm states that a firm must first have some competitive advantage in its home market - "O" or *owner-specific* – which can be transferred abroad

The firm must also be attracted by specific characteristics of the foreign market – "L" or *location specific* – which will allow the firm to exploit its competitive advantages in that market; Third ,the firm will maintain its competitive position by attempting to control the entire value-chain in its industry – "I" or *internalization*; This leads to FDI rather than licensing or outsourcing, financial strategies are directly related to the OLI Paradigm in explaining FDI. Strategies can be proactive, controlled in advance by the management team. Strategies can also be reactive, depend on discovering market imperfections

The OLI Paradigm & Internalization

	Ownership Advantages	Location Advantages	Internalization Advantages
Proactive Financial Strategies			
1. Gaining and maintaining a global cost and availability of capital			
• Competitive sourcing of capital globally	X	X	
• Strategic preparatory cross-listing	X		
• Providing accounting and disclosure transparency	X		
• Maintaining competitive commercial and financial banking relationships	X		
• Maintaining a competitive credit rating	X	X	X
2. Negotiating financial subsidies and/or reduced taxation to increase free cash flow	X	X	
3. Reducing financial agency cost through FDI			X
4. Reducing operating and transaction exposure through FDI	X		
Reactive Financial Strategies			
1. Exploiting undervalued or overvalued exchange rates		X	
2. Exploiting undervalued or overvalued stock prices		X	
3. Reacting to capital control that prevents the free movement of funds		X	
4. Minimizing taxation		X	X

Where to Invest

Two related behavioral theories behind FDI that are most popular are: ***Behavioral Approach*** – Observation that firms tended to invest first in countries that were not too far from their country in psychic terms, This included cultural, legal, and institutional environments similar to their own

International network theory – As MNEs grow they eventually become a network, or nodes that operate either in a centralized hierarchy or a decentralized one, each subsidiary competes for funds from the parent, It is also a member of an international network based on its industry, the firm becomes a transnational firm, one that is owned by a coalition of investors located in different countries.

How to Invest Abroad: Modes of FDI

Exporting vs. production abroad

Advantages of exporting are: None of the unique risks facing FDI, joint ventures, strategic alliances and licensing. Political risks are minimal. Agency costs and evaluating foreign units are avoided

Disadvantages are: Firm is not able to internalize and exploit its advantages. Risks losing market to imitators and global competitors

Licensing/management contracts versus control of assets abroad

Licensing is a popular method for domestic firms to profit from foreign markets without the need to commit sizable funds.

Disadvantages of licensing are: License fees are likely lower than FDI profits although ROI may be higher. Possible loss of quality control. Establishment of potential competitor. Possible improvement of technology by local license which then enters firm's original home market. Possible loss of opportunity to enter licensee's market with FDI later, Risk that technology will be stolen, High agency costs

Management contracts are similar to licensing insofar as they provide for some cash flow from foreign source without significant investment or exposure, These contracts lessen political risk because the repatriation of managers is easy

Joint ventures versus wholly owned subsidiary
A *joint venture* is a shared ownership in a foreign business; this is a viable strategy if the MNE finds the right local partner, some advantages include: The local partner understands the market
The local partner can provide competent management at all levels; some host countries require that foreign firms share ownership with local partner

Joint ventures versus wholly owned subsidiary
Advantages of joint ventures: The local partner's contacts & reputation enhance access to host country's capital markets; The local partner may possess technology that is appropriate for the local environment; The public image of a firm that is partially locally owned may improve its position

Disadvantages of joint ventures: Political risk is increased if wrong partner is chosen. Local and foreign partners have divergent views on strategy and financing issues. Transfer pricing creates potential for conflict of interest. Financial disclosure between local partner and firm. Ability of a firm to rationalize production on a worldwide basis if that would put local partner at disadvantage. Valuation of equity shares is difficult

Greenfield investment versus acquisition
A *Greenfield investment* is establishing a facility "starting from the ground up"
Usually require extended periods of physical construction and organizational development
Here, a cross-border acquisition may be better because the physical assets already exist, shorter time frame and financing exposure, However, problems with integration, paying too much for acquisition, post-merger management, and realization of synergies all exist, strategic alliances can take several different forms: First is an exchange of ownership between two firms, It can be a defensive strategy against a takeover, In addition to exchanging shares, a separate joint venture can be developed, Another level of cooperation may be a joint marketing or servicing agreement.

2.8 Political Risk Assessment and Management:

Define and classify foreign political risks, analyze firm-specific risks, examine country-specific risks, identify global-specific risks

2.8.1Defining Political Risk

In order for an MNE to identify measure and manage its political risks, it needs to define and classify these risks: ***Firm-specific*** are those risks that affect the MNE at the project or corporate level (governance risk due to the goal conflict between an MNE and its host government being the main political firm-specific political risk in chapter; business risk and FX risk are also in this category). ***Country-specific*** are those risks that also affect the MNE at the project or corporate level but originate at the country level (e.g. transfer risk, war risk, nepotism & corruption).***Global-specific*** are those risks that affect the MNE at the project or corporate level but originate at the global level (e.g. terrorism, anti-globalization, poverty)

2.8.2 Assessing Political Risk

How can multinational firms anticipate government regulations that, from the firm's perspective, are discriminatory or wealth depriving? at the macro level, firms attempt to assess a host country's political stability and attitude toward foreign investors, at the micro level, firms analyze whether their firm-specific activities are likely to conflict with host-country goals as evidenced by existing regulations, the most difficult task is to anticipate changes in host-country goal priorities

Predicting Firm-Specific Risk (Micro-Risk): the need for firm-specific analyses of political risk has led to a demand for "tailor-made' studies undertaken in-house by professional political risk analysts. In-house political risk analysts relate the macro risk attributes of specific countries to the particular characteristics and vulnerabilities of their client firms, certainly, even the best possible analysis will not reflect unforeseen changes in the political or economic situation

Predicting Country-Specific Risk (Macro-Risk): macro political risk analysis is still an emerging field of study; these studies usually include an analysis of the historical stability of the country in question, evidence of present turmoil or dissatisfaction, indications of economic stability, and trends in cultural and religious activities; it is important to remember, especially in the analysis of political trends, that the past will certainly not be an accurate predictor of the future

Predicting Global-Specific Risk: predicting this type of risk is even more difficult than the other two types of political risk, the attacks of September 11th, 2001 are an important example of theses difficulties, however, the military buildup in Afghanistan was not as difficult to predict, as we now live in a world with an expectation of future terrorist attacks, we may begin to see country-specific terrorism or other risk indices being developed

2.8.3 Firm-Specific Risks

Governance Risk: this is the ability to exercise effective control over and MNE's operations within a country's legal and political environment, for an MNE, however, governance is a subject similar in structure to consolidated profitability – it must be addressed for the individual business unit and subsidiary as well as for the MNE as a whole

Negotiating investment agreements: an ***investment agreement*** spells out the rights and responsibilities of both the foreign firm and the host government; the presence of MNEs is as often sought by development-seeking host governments as a particular foreign location sought by an MNE, an investment agreement should spell out policies on financial and managerial issues; including the following; basis on which fund flows such as dividends, royalty fees and loan repayments may be remitted. Basis for setting transfer prices. The right to export to third-country markets. Obligations to build, or fund social and economic overhead projects such as schools and hospitals. Methods of taxation, including rate, type and means by which rate is determined. Access to host country capital markets. Permission for 100% foreign ownership versus required local partner. Price controls, if any, applicable to sales in host country's markets. Requirements for local sourcing versus importation of materials. Permission to use expatriate managerial and technical personnel. Provision for arbitration of disputes. Provisions for planned divestment, indicating how the going concern will be valued (build-to-own or build-to-transfer)

2.8.4 Investment insurance and guarantees: OPIC on USA: MNEs can sometimes transfer political risk through an investment insurance agency, the US investment insurance and guarantee program is managed by the Overseas Private Investment Corporation (OPIC), it's stated purpose is to mobilize and facilitate US private capital and skills in the economic development of less developed countries, OPIC offers coverage for

four separate types of risk: *Inconvertibility* - risk that the investor will not be able to convert remittances into dollars. *Expropriation* – risk that the host government will seize the assets of the US investor without restitution payments. *War, revolution & insurrection* – covers damages to physical property of foreign subsidiary. *Business income* – coverage provides compensation for loss of income due to events from political violence that directly affect the company & its assets

2.8.5 Operating Strategies (After the FDI Decision): although FDI creates obligations on the part of the foreign subsidiary and host government, conditions change and the MNE must be able to adapt, there are several strategies that an MNE can undertake to anticipate changing conditions or host government's future actions and negotiate these terms. ***Local sourcing*** – firms may be required to purchase raw materials from local producers. ***Facility location*** – facilities may be located to minimize risk. ***Control of transportation*** – most important for oil and pipeline companies. ***Control of technology*** – control of key patents and intellectual property. ***Control of markets*** – common practice in order to enhance a firm's bargaining position. ***Brand name & trademark control*** – gives MNE ability to operate under a world brand name. ***Thin equity base*** – foreign subsidiaries can be financed with a thin equity base and large proportion of local debt. ***Multiple-source borrowing*** – firm can borrow from various banks and countries

2.8.6 Country-Specific Risks: these risks affect all firms, both domestic and foreign operating within the host country, most typical risks are:

***Transfer risk* are the limitations on the MNE's ability to transfer funds into and out of a host country without restrictions, MNEs can react to potential transfer risk at three stages, p**rior to making the investment, a firm can analyze the effect of blocked funds. During operations a firm can attempt to move funds through a variety of repositioning techniques. Funds that cannot be moved must be reinvested in the local country to avoid deterioration in real value. AN **MNE has at least six strategies for transferring funds under restrictions:** Providing alternative conduits for repatriating funds. Transfer pricing goods & services between subsidiaries. Leading and lagging payments. Using fronting loans. Creating unrelated exports. Obtaining special dispensation

Fronting loans: A *fronting loan* is a parent-to-subsidiary loan channeled through a financial intermediary. The lending parent deposits the funds in a bank, let's say in London. That bank in turn "loans" this amount to the borrowing subsidiary. In essence, the bank "fronts" for the parent

Creating unrelated exports: Because main reason for stringent exchange controls is a host country's ability or inability to earn hard currency, anything an MNE can do to generate export sales helps the host country, some exports can be created from present productive capacity or through production of unrelated products and services for export

Special dispensation: if the firm is in an important industry for the development of the host country, it may bargain for a special dispensation to repatriate some funds

Cultural and Institutional: when investing in some of the emerging markets, MNEs that are resident in the most industrialized countries face serious risks because of cultural and institutional differences such as: Differences in allowable ownership structure, differences in human resource norms, and differences in religious heritage, nepotism and corruption in the host country, protection of intellectual property rights, protectionism

2.8.7 Global-Specific Risks: global-specific risks faced by MNEs have come to the forefront in recent years: terrorism and War. Crisis Planning. Cross-Border Supply Chain

Integration. Supply Chain Interruptions (Inventory Management, Sourcing, Transportation). antiglobalization Movement. Environmental Concerns, Poverty, Cyberattacks

Meaning of Foreign Direct Investment (FDI)
Concept of control: control must accompany the investment, 100 percent share does not guarantee control, government intervenes in company operations, and direct investment usually implies an ownership share of 10 to 25 percent. Concern about control: government concern, when foreign investors control a company, decisions of national importance may be made abroad. Investor concern: transfer of resources to acquiring company, appropriability theory, company receiving resources may undermine the competitive position of the company transferring them. Internalization control by self-handling of operations.

2.9 The models of pre-network internationalization

2.9.1 The Uppsala and innovation-related internationalization models

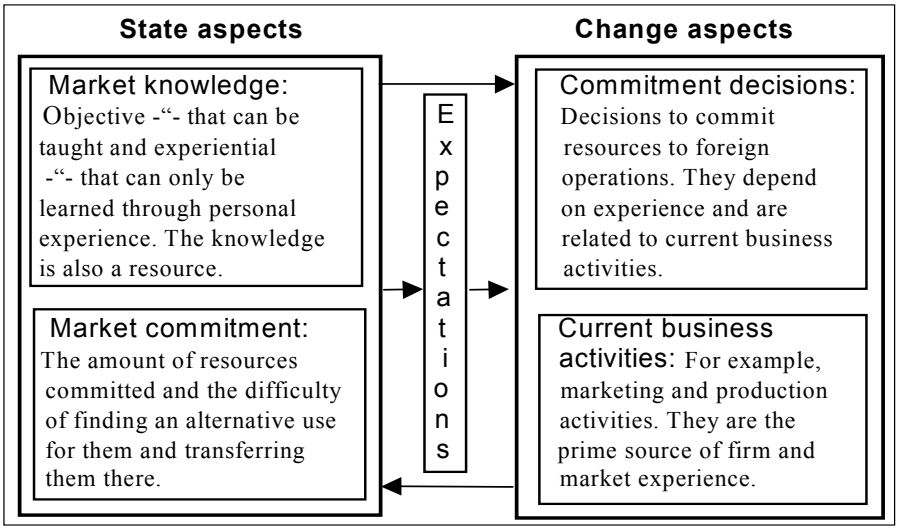
A large quantity of research has been based on the **Uppsala** (or the **U-** or the **internationalization process**) **model**. J. Johanson and J-E. Vahlne (1990) have stated that the model has been primarily based on the behavioral theory of the firm (Aharoni 1966; Cyert and March 1963), the theory of the growth of the firm (Penrose 1959) and empirical research about Swedish companies competing internationally (Carlson 1966, 1975). The Uppsala model focuses on the development of the individual enterprise (Johanson and Vahlne 1977). The authors make the following assumptions (Johanson and Vahlne 1977, 1990; Johanson and Wiedersheim-Paul 1975; Vahlne and Johanson 2002).

Internationalization is usually a long, slow and incremental process.
Experiential market knowledge, for example, about how to do business in a specific foreign country, generates business opportunities and consequently is the driving force of the internationalization process.
Lack of knowledge about foreign markets and operations is an important obstacle to the development of international operations. The necessary knowledge can be acquired mainly through operations abroad.
The acquisition, integration and use of knowledge about foreign markets and operations are gradual.
Knowledge also reduces market risk and uncertainty. Consequently, in a specific country, companies are expected to make stronger commitments to foreign markets and operations incrementally as they gain experience from current activities in the market.
Because of a lack of knowledge about foreign countries and a propensity to avoid uncertainty, firms first begin to export to neighboring countries or those that are comparatively well known and similar.

These assumptions lead to two directions of internationalization. The first direction means that companies are supposed to enter new markets with successively greater psychic distance[1]. The second direction is that the market investments develop according to an establishment chain (Johanson and Vahlne 1990). In other words, the enterprises pass through a number of logical steps from a situation of no regular export activities to export

via independent representatives or agents, overseas sales subsidiaries and production/ manufacturing units (Johanson and Wiedersheim-Paul 1975).

The basic mechanism of internationalization is shown in Figure 2. As knowledge is also a resource, the better knowledge about the country increases the value of the resources and leads to a stronger commitment to the market. Knowledge and experience, in turn, can be acquired through a long learning process in connection with current business activities. For this reason, the internationalization process is often slow. Commitment decisions also depend on experience gained from current business activities. As a result, additional commitments will be made in Small steps (Johanson and Vahlne 1977).



The basic mechanism of internationalization: state and change aspects (Sources: based on Johanson and Vahlne 1977 and Hadjikhani and Johanson 2002).

In 2002, M. Johanson added a fifth dimension — expectations — to explain why some firms internationalize faster than the U-model suggests. They proposed that if a company expects a favorable change in its business environment, it might take more risks in its internationalization: for example, invest more resources. Negative expectations, in turn, should slow down the internationalization process (Hadjikhani and Johanson 2002). There are also three other exceptions to the Uppsala model (Johanson and Vahlne 1990). Large enterprises or those with substantial resources can more easily internationalize. In stable market conditions, the relevant market knowledge can be obtained in other ways than through experience. When a company has considerable experience in similar markets, it may make use of it in a specific country. In 1993, it was shown that in addition to the firm characteristics, the Uppsala model's ability to explain the patterns of internationalization process depends on industry characteristics.

- The internationalization in different companies and industries

	National industry	Regional industry	Global industry
Global firm	The firm is much stronger than its competitors. It can enter whatever markets in whatever order it prefers.	The enterprise is more powerful and experienced than its competitors. The choice of markets, entry modes and timing may vary.	Any market entry form is possible. The company's strategy and choice of foreign markets depends on its competitive position.
Regional firm	The enterprise is a strategic inventor and has strong firm-specific advantages. It can internationalize faster than the national firm: enter more markets at once and leapfrog some stages.	The company can internationalize in a traditional way if it follows a focused strategy and has limited resources. In some cases, it may internationalize faster than the U-model traditionally predicts.	This firm is not very powerful but can be perceived as a threat. Competitors may take countermoves to threaten it. The company's internationalization depends on its competitive position.
National firm	Internationalization is based on a set of firm-specific advantages. The company enters the neighboring market and uses local agents/distributors first.	The firm goes international from a niche position. It enters the areas or product segments of less interest to main competitors. The entry process is slow and sequence traditional.	The enterprise mostly relies on a focus or niche strategy. It has a weak competitive position and thus enters the foreign markets or market segments unattractive to large competitors.

Source: based on Vahlne 1993

The U-model is most appropriate for national firms in national and regional industries and regional companies in national industries. It is least appropriate — the exceptional case prevails — for global enterprises in regional and global industries and regional firms in global industries (Vahlne 1993).

J.-E. Vahlne and J. Johanson studied 15 non-IT and eight IT companies in 2002 and noted that the main assumptions of the U-model — the gradually increasing geographical extension and deepening commitment to the markets entered — were not the same as in the 1970s. On the other hand, the differences seemed to be a matter of degree rather than of kind (Vahlne and Johanson 2002).

- The psychic distance still has an impact on the order in which national markets are entered but it has probably decreased while firms' ability to cope with it has increased. Although the Internet is widely used and that has made the world appear smaller, the non-IT enterprises mostly follow the traditional sequence of starting close to home and then gradually entering more culturally distant markets. The IT companies also begin from their home market but internationalize almost at once.
- The enterprises still gradually increase their commitment in foreign markets. The non-IT firms proceed from ad hoc types of exporting to more regular, routine business. Some companies may also form sales subsidiaries. The IT firms enter by "greenfield" or by acquisition very rapidly. Then, they increase their commitment by continued investments in building competence and capacity in the local organizations.
- On the whole, the enterprises develop according to the model. Those that perform almost no current activities in the foreign markets; do not also learn anything about the customers and markets. In the good times, the companies may expand rapidly to exploit what they consider a first mover advantage, which, however, is no advantage at all if they do not invest in relationships with the customers.

From the Uppsala model, the following four conclusions can be drawn. First, a lack of foreign market knowledge leads to a slow internationalization process. Second, companies usually enter similar countries first. Third, enterprises will progress from simpler to steadily more demanding market operation forms. Fourth, this model mostly applies to smaller and less experienced firms that have fewer resources

2.9.3 Innovation-related internationalization (or I-) models focus on the learning sequence connected with the adoption of an innovation. They are derived from the stages of the individual adoption process: awareness, interest, evaluation, trial and adoption of an innovation (Rogers 1962). K. Simmonds and H. Smith (1968) were among the first to study export behavior as a marketing innovation. They considered that entry into exporting could be traced to an "innovator", an individual possessing aggressive and competitive traits, with greater tolerance of risk than his/her counterpart in the firm and motivated by perceived rewards stemming directly from exporting as a strategy of its growth. even stated that in small business internationalization, the decision-maker of the enterprise is the key variable. In I-models, several other factors and agents influencing enterprises' export initiation and behavior patterns have also been demonstrated for example, firm characteristics, national policies, competitors' actions and market conditions.

The determinants of export marketing behavior

Internal	External
• General firm characteristics: size, goals; background, past performance, ownership structure and reputation. • Differential company advantages: the nature of its products, markets, technological orientation, financial resources and information about foreign markets. • Decision-maker characteristics: age, country of birth, value system, past history, experience in foreign markets and behavior in uncertain situations. • The strength of managerial aspirations for various business goals: for example, growth, profit and market development. • Management expectations about the effects of exporting on business goals. • The level of organizational commitment to export marketing, including willingness to learn and devote adequate resources to export-related activities.	• National policies: for example, export incentives, export support services, provision of information about foreign market opportunities and currency devaluation. • Regional trading agreements. • Home country conditions: size, domestic demand, competition, the workforce's education level, production and transport costs, linkages between industries, legislation, infrastructure and institutional framework. • Industry characteristics, including foreign and domestic competition and market demand. • Foreign market conditions: size, competition, tariff and non-tariff trade barriers, product standards; geographic and cultural distance from the host country. • Marketing activities by competitors in foreign markets. • Industrial and trade associations. • Unsolicited export orders.

Sources: Bilkey 1978; Bilkey and Tesar 1977; Calof and Viviers 1995; Cavusgil 1984; Cavusgil and Nevin 1981; Lee and Brasch 1978; Leonidou and Katsikeas 1996; Pinney 1970; Pavord and Bogart 1975; Reid 1981, 1983; Simmonds and Smith 1968; Wiedersheim-Paul et al. 1978; Wind et al. 1973.

It has been demonstrated that some forces influence foreign-owned firms' internationalization more than that of their domestic counterparts. For example, the initial decision to start exporting could be taken in the headquarters as a result of a global marketing decision and sales might be organized through a global marketing network (Wiedersheim-Paul et al. 1978).

Although the U- and I- models differ in terms of the factors influencing international expansion, they have some similarities. The authors agree that companies internationalize step-by-step (see Appendix 1). Each new step represents more experience/involvement than the earlier stages (Andersen 1993). They state that a company proceeds abroad through temporally defined, sequential and stage-wise process. Foreign market expansion is incremental and dependent on an enterprise's experiential learning and uncertainty regarding the decision to internationalize (Fina and Rugman 1996; Morgan and Katsikeas 1997).

In different I-models, the number of internationalization stages varies from three (Leonidou and Katsikeas 1996; Moon and Lee 1990) to eight (Reid 1983). Although the researchers have brought out different stages of the firm's export development process, they all portray a common idea that its decision to go international is a gradual process that can be subdivided (Czinkota 1982). Based on the I-models showed in the Appendix 1, the following hypothetical internationalization process can be pictured.

1- The domestic firm: there is no international activity. The company's management is not interested in exporting; it does not collect any export information. It would not even accept an unsolicited export order.
2- Passive activity: the enterprise does not actively seek export opportunities but will accept unsolicited export orders. It starts collecting information about foreign markets but may still lack basic data about costs, exchange risks and distribution.
3- The exploring stage: the management actively explores the feasibility of exporting and makes export plans. It collects more export information.
4- Indirect exporting via domestic agents, manufacturing representatives, commission agents. Exports per turnover are low.
5- Indirect exporting via foreign distributors. Exports per turnover are low- medium.
6- The experimental direct exporting stage: the firm exports directly a small amount on an experimental basis to some psychologically close country. It acquires basic export experience.
7- The stage of increasing direct exporting: The company is semi-experienced but still exports relatively little to a single foreign market. It has a favorable attitude and active involvement in exporting.
8- The stage of experienced direct exporting: the enterprise is an experienced exporter to that country and adjusts exports optimally to changing exchange rates, tariffs and other factors. It makes future export plans.
9- The stage of export growth: the management tries to export to some other countries that are psychologically farther away. A suitable organizational structure is created to support these activities.
10- The stage of substantial export involvement: the firm depends heavily on exports. It concentrates on the most attractive markets and develops them in depth.
11- The stage of seeking alternative entry modes*:* the enterprise tries to use licensing or some other entry modes.
12- The stage of foreign sales subsidiaries: the company establishes foreign sales subsidiaries.
13- The stage of foreign production: the firm founds a production subsidiary.
14- The regional company: the enterprise views the entire region as a potential market.
15- The global company: the company views the entire world as a potential market.

From the innovation-related internationalization models, it can be concluded that the firms' export development process can be divided into three broad phases. They are the following (Leonidou and Katsikeas 1996).
The pre-engagement phase includes three types of companies: those selling their goods solely in the domestic market and not interested in exporting; those involved in the home market but seriously considering export activity; and those that used to export in the past but no longer do so.
During the initial phase, the enterprise is involved in sporadic export activity and considers various options. Here, companies can be classified as having the potential to increase their overseas involvement, and as being unable to cope with the demands of exporting, leading to marginal export behavior or withdrawal from selling abroad altogether.
Finally, in the advanced phase, the firms are regular exporters with extensive overseas experience and frequently consider more committed forms of international business.

From the 15 stages shown above, stages 1-3 could be classified to the pre-engagement phase, 4-7 to the initial phase and 8-11 to the advanced phase. The last four stages represent the phase of a higher international commitment left out from this classification.

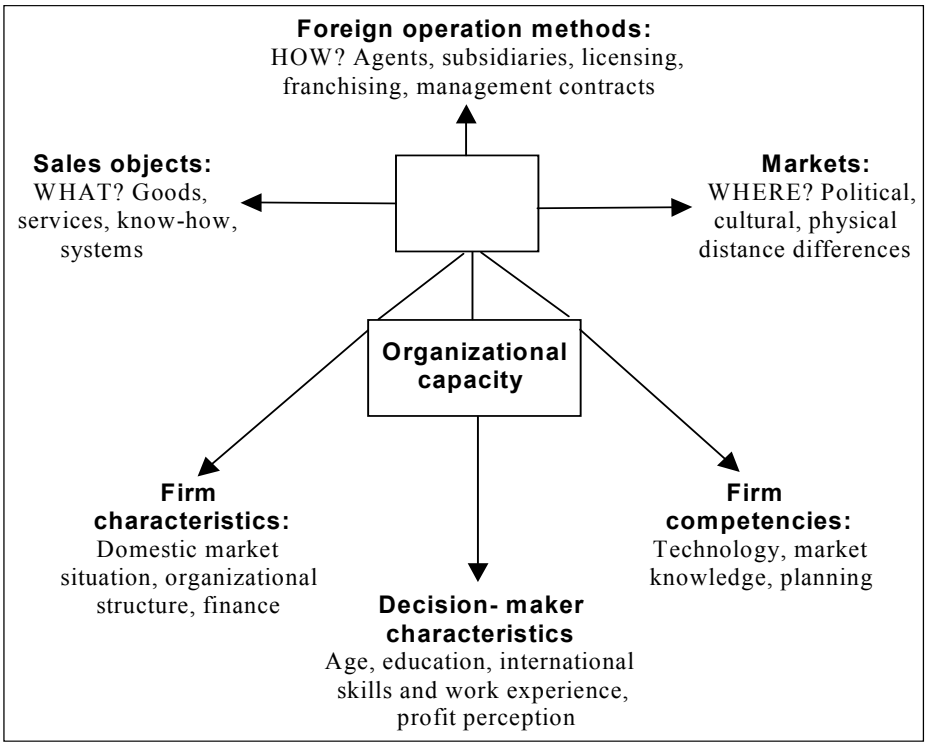
As it was demonstrated in the three broad phases, developed by Leonidou and Katsikeas (1996), the I-models do not exclude a possibility for a company to withdraw from export operations, for example, because of some negative experiences or because export operations were used only as a temporary help to domestic operations (Wiedersheim-Paul et al. 1978). It is also possible that an enterprise uses some entry modes simultaneously (Reid 1981).
From the I-models, we can conclude besides knowledge, many other factors influence firms' internationalization. Individual decision-makers may considerably affect a company's internationalization process. In addition, we can say that foreign-owned firms' internationalization could be influenced by different factors and thus differ from local companies' internationalization.

2.10. The other approaches to pre-network internationalization

2.10. 1- The Finnish model agrees with the Uppsala and the innovation-related internationalization models that firms start their internationalization from culturally similar countries. In this model, cultural distance is defined as the "sum of factors creating, on the one hand, a need for knowledge, and on the other hand, barriers to the knowledge flow and hence also for other flows between the home and target countries" (Luostarinen 1979, pp. 131–132).

Like the U-and I-models, the authors of this model show that at first, firms tend to penetrate the countries that are closest in physical, political, economic and cultural terms. As they gain confidence, the companies might seek more distant markets. The Finnish model also agrees with the above- mentioned two models that as the enterprises internationalize, they may change the method of operating, for example, move from the stage of no exporting to exporting via an agent, then, creating a sales subsidiary, and finally, founding a production subsidiary (Luostarinen 1979; Luostarinen and Welch 1997; Welch and Luostarinen 1988).

In addition to the two dimensions — markets and market operation modes — already examined in the previous two internationalization models, the authors of the Finnish model add four more (see Figure 3): sales objects, firm characteristics, decision-maker characteristics and firm competencies. Consequently, the model implies that internationalization is not a one-dimensional concept (Luostarinen 1994). A company can internationalize in some categories more than others. For example, it can increase its internationalization not only in terms of depth of operational mode as the U- and I-models suggest, but also through diversity, by using various operational forms, offering a varied product range and penetrating dissimilar markets (Chetty 1999; Luostarinen and Welch 1997).



The model also suggests that firms can leapfrog some stages and speed up their internationalization (Chetty 1999). The most frequent two-staged penetration processes are export → direct investment, licensing → direct investment, and assembling → direct investment. Three-staged internationalization is also common (Luostarinen 1970). Similarly to the U-model, the Finnish model implies that large companies, based in large domestic markets, should reveal more advanced involvement far earlier and generally move through the internationalization process at a faster rate than smaller enterprises from smaller countries (Luostarinen and Welch 1997).

The authors of the Finnish model recognize that during their internationalization, firms use a wide variety of operation modes. While the other studies usually include traditional export operations, licensing and FDI, the Finnish model examines in total 15 investment and non-investment, marketing and production operations (see Table 1).

Table 1. Categories of outward operations

	Marketing operations — MOS	**Production operations — POS**
Non-investment operations — NIOS	Non-investment marketing operations — **NIMOS** • Export operations: indirect, direct and own exporting[2]. • Marketing and management contracts. • Distribution and service franchising.	Non-investment production operations — **NIPOS** • Licensing. • Production management contracts. • Production franchising. • Contract manufacturing. • Project operations. • Co-production.
Direct investment operations — DIOS	Direct investment marketing operations — **DIMOS** • Marketing units. • Warehousing units. • Service units. • Sales units.	Direct investment production operations — **DIPOS** • Assembly units. • Manufacturing units.

Sources: based on Luostarinen 1970, 1979 and Luostarinen and Welch 1997.

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According to this model, most companies start their internationalization from goods and then move to services, systems and know-how. Using the terminology of Table 3, they usually start with NIMOS and then move to DIMOS, NIPOS and DIPOS (Luostarinen 1979) but the sequence NIMOS → NIPOS → DIMOS → DIPOS has also been observed (Korhonen 1999). In addition, most enterprises at first move to very close markets and afterwards select close, medium, distant and very distant countries (Luostarinen 1979). This combination of deepening commitment of resources and diversity of operation method, products and markets may help the firms to leapfrog some stages and speed up their internationalization (Chetty 1999; Luostarinen and Welch 1997).

The model also claims that internationalization is a two-way phenomenon. This means that in addition to the outward operations, shown in Table 3, inward internationalization and cooperative modes should be studied (see Table 2). The inward internationalization process might precede and influence the development of outward activities and vice versa (Fletcher 2001; Korhonen 1999). For example, many companies have their first international contacts as potential customers of foreign enterprises. This may lead to imports of machinery, technology or some other products, which are part of an initial inward internationalization process (Luostarinen and Welch 1997; Welch and Luostarinen 1993). Sometimes, firms may acquire foreign market knowledge, reduce risk and uncertainty and the time required to establish new international operations (Karlsen et al. 2003). In addition, they may develop contact networks that may afterwards result in an outward selling or investment move (Luostarinen and Welch 1997; Welch and Luostarinen 1993). These relationships, in turn, can be later used for sourcing (Korhonen 1999).

Table 2. Inward, outward and cooperation modes

Outward operation modes	Inward operation modes	Cooperation modes
• Indirect/direct/own export. • Licensing, selling. • Know-how agreement. • Franchising. • Subcontracting. • Contract manufacturing. • Project exporting. • Joint/mixed venture.	• Indirect/direct/own import. • Licensing, buying. • Know-how agreement. • Franchising. • Subcontracting. • Contract manufacturing. • Project exporting. • Joint/mixed venture.	• Cooperation on manufacturing. • Cooperation on purchasing. • Cooperation on R&D.

Sources: based on Luostarinen 1994 and Luostarinen and Welch 1997

In the same way as the outward side, international inward operations are assumed to develop in the order of non-investment buying operations → direct investment buying operations → non-investment production operations → direct investment production operations (Korhonen 1999). After successfully testing its competitive capabilities and reaching a dominating market share, the firm usually starts its outward internationalization process. Finally, the enterprises realize the need of cooperation with

foreign companies, that is, different types of strategic alliances[3] and networks. They may start cooperating on technological know-how, production, marketing, purchasing and transporting (Luostarinen 1994; Luostarinen and Hellman 1994).

In addition, similarly to the I-models, the Finnish model shows that a firm does not inevitably move to the last step of development: the reverse of the process, or de-internationalization, may occur at any of the stages, particularly in the early steps of export development (Welch and Luostarinen 1988). The backward process may be followed again by advancing steps. That means internationalization may be followed by de- and re-internationalization (Luostarinen 1994).

From the Finnish model, we can draw the following conclusions. First, inward internationalization (for example, inward FDI or imports from foreign suppliers) can have a considerable impact on firms' outward internationalization. Second, the internationalization process may also include de- and re-internationalization. Third, sometimes, firms can leapfrog some stages and speed up their internationalization. Fourth, an enterprise can increase its internationalization in some dimensions more than others.

The interest in **born globals** has arisen in the early 1990s (Moen and Servais 2002). This subject has received considerable attention in the international entrepreneurship literature. From start-up, these enterprises view the world as their marketplace (McDougall et al. 2003). Consequently, they leapfrog into internationalization rather than move cautiously through a series of incremental steps as suggested by the stage theories (Knight and Cavusgil 1996; Rennie 1993), examined before. This happens despite the fact that the companies' resources are constrained by their young age and small size, their markets are most volatile and these firms, by definition, have little or no experience in any market (Oviatt and McDougall 1994). Consequently, the exceptions to the Uppsala model, introduced in the previous subchapter, do not include this type of firms.

Numerous studies have been made on this phenomenon using different terms: born globals (Andersson and Wiktor 2001; Autio et al. 2000; Bell et al. 2001; Harveston et al. 2000; Knight and Cavusgil 1996; Madsen and Servais 1997; Madsen et al. 1999; McKinsey & Co 1993; Moen and Servais 2002; Rasmussen and Madsen 2002; Rennie 1993), global start-ups (Oviatt and McDougall 1994, 1995), international new ventures (Knudsen and Madsen 2002; McDougall et al. 1994, 2003; McDougall and Oviatt 1996; Oviatt and McDougall 1994, 1997), new international ventures (Knight 2001), high technology start-ups (Jolly et al. 1992), infant multinationals (Lindqvist 1997), instant multinationals (Litvak 1990), instant internationals (Preece et al. 1999), instant exporters (McAuley 1999) and virtual instant global entrepreneurs (Katz et al. 2003). As the term born global seems to be more widely spread than the others, it will be also used in this thesis.

A born global is a company that has reached a share of foreign sales of at least 25 percent within three years after its birth and seeks from inception[4] to derive significant competitive advantage from the use of resources and the sales of outputs in multiple

countries (Andersson and Wiktor 2001). In contrast to organizations that evolve gradually from domestic firms to multinationals, born globals begin with a proactive international strategy. However, these companies do not necessarily own foreign assets: FDI is not a requirement (Oviatt and McDougall 1994). Consequently, some enterprises may not complete the internationalization process (Crick 1995) as it was viewed in the U- and I-models. Moreover, instead of establishing sales or production subsidiaries, they may arrange strategic alliances to use foreign resources such as manufacturing capacity or marketing (Oviatt and McDougall 1994).

Several recent trends have given rise to the emergence of born globals: the increasing role of niche markets, specialized and customized products, shorter product life cycles, larger domestic and international competition, global networks, advances in process and communication technology and inherent advantages of small companies: for example, quicker response time, flexibility and adaptability (Coviello and Munro 1995; Knight and Cavusgil 1996; Rennie 1993). Some other factors have also influenced the emergence of these firms: the background of the founder (including family background, education, experience from living abroad, experience from other internationally oriented jobs and business skills), product and industry characteristics, the country where the enterprise is located (Madsen and Servais 1997; McAuley 1999), firm size, unique resources, financial strength, R&D spending, the firm's reputation and network (Zahra and George 2002). The born globals may be able to compensate the lack of a broad resource base by using a narrow but critical set of skills. Internationally experienced managers may also allow them to effectively compete in a broader domain (Wolff and Pett 2000). It has been found that born globals are generally the firms where the top management has a desire and commitment to export. The companies, which compete on value (mainly quality, technology and product design) and those with a strong customer orientation, belong to this category as well (McKinsey & Co 1993).

A new term, born-again global, has been created to refer to the firms that have been well established in their domestic markets, with apparently no great motivation to internationalize, but which have suddenly embraced rapid and dedicated internationalization. Mostly, this change has been caused by a critical incident: for example, takeover by another enterprise, acquisition of a company with international connections or the internationalization of a domestic client (Bell et al. 2001).

From the research on born globals, it can be concluded that some firms can internationalize very quickly despite being small, having limited resources, no market experience and acting in most volatile markets. A critical incident (for example, a change in ownership) may trigger a company's internationalization.

2.10. A - The importance and limitations of the literature on pre-network internationalization

The importance and limitations of the Uppsala, innovation-related and the Finnish models will be demonstrated. Thereafter, some similarities and differences between the importance and critiques of the three models will be analyzed.

2.10. 1 - The Uppsala model has been widely used in the internationalization literature (Andersen 1993; see also Table 5). This model is simple and easily understandable. At the same time, it can explain the total internationalization process (Pedersen 1999): from initially small export activities in a couple of the nearest countries to the

establishment of foreign production subsidiaries in more distant regions. In addition, the Uppsala model has received both empirical and theoretical support (Forsgren 2000; Johanson and Vahlne 1990), especially for smaller and medium-sized (Korhonen 1999) firms in the earlier stages of development (Forsgren 1989), acting in national industries (Petersen and Pedersen 1997) and small domestic markets (Korhonen 1999). The U-model emphasizes the importance of knowledge and business experience in the enterprises' internationalization (Pedersen 1999). the lack of knowledge should lead to a slow internationalization process.

Table 3. The importance and limitations of the Uppsala model

Importance	Limitations
Dynamic.	Overemphasizes the role of market-specific knowledge.
Well-known.	Does not include all (hybrid) entry modes.
Introduces the importance of knowledge and business experience.	Too deterministic: leaves no strategic choices for individuals.
Makes clear the importance of cautious and incremental steps.	Does not explain "leapfrogging" behavior and decreasing foreign commitment.
Valid for firms of any size.	Ignores the costs and the beginning of internationalization.
Got considerable empirical and theoretical support.	Is less suitable for services.
Simple and easy to understand.	Its simplicity could hamper developing other explanations of internationalization.
Analyzes the total internationalization process.	

Sources: Andersen 1993, 1997; Andersson 2000; Arenius 2002; Autio et al. 2000; Axinn and Matthyssens 2002; Bell 1995; Cantwell and Narula 2001; Chetty 1999; Coviello and Martin 1999; Crick and Jones 2000; Eriksson et al. 1997; Forsgren 1989, 2001; Hedlund and Kverneland 1985; Johanson and Mattson 1988; Knight and Cavusgil 1996; Lam and White 1999; Luostarinen and Welch 1997; Madsen and Servais 1997; McDougall et al. 1994; Melin 1992; Moen and Servais 2002; Morgan and Katsikeas 1997; Oviatt and McDougall 1999; Pedersen 1999; Pedersen et al. 2001; Petersen and Pedersen 1997; Reid 1983; Rennie 1993; Sullivan and Bauerschmidt 1990; Turnbull 1987; Westhead et al. 2001; Wolff and Pett 2000

Several authors have criticized the U-model for overemphasizing the difficulty of acquiring knowledge (Forsgren 1989; Hedlund and Kverneland 1985). Even the authors of the Uppsala model have admitted that in the later stages of the internationalization process, the firms have already acquired the necessary knowledge and consequently do not have to enter closest countries first (Johanson and Vahlne 1990). In addition, the Uppsala model has been often criticized for being too deterministic (Melin 1992; Turnbull 1987) — it proposes that companies move through four stages: no export activities, exporting, foreign sales and production/manufacturing units. As we concluded from the subchapter 1.1.1, for this model, skipping some stages is an exception, not a rule. The model also excludes "leapfrogging" behavior (Bell 1995) and some foreign market entry modes and does not explain why firms inevitably have to move from the exporting stage to foreign sales and production subsidiaries (Pedersen 1999). In addition, it underemphasizes the role of individuals (Arenius 2002) — for example, the top management (Andersson 2000) and several other important factors in the companies' internationalization (Andersen 1993; Pedersen 1999). Moreover, the Uppsala model offers little managerial advice (Lam and White 1999); does not explain how the internationalization process will start (Andersen 1993; Lam and White 1999), is less suitable for services (Axinn and Matthyssens 2002) and does not include the costs of internationalization (see Table 3).

2.10. 2- The innovation-related internationalization models have also received general acceptance and considerable empirical support in the international business literature (Andersen 1993; Gankema et al. 2000; Leonidou and Katsikeas 1996). As it was shown in Table 2, besides knowledge, these models identify a large number of other variables (both internal and external) that influence the companies' export behavior. Size, the nature of their products, the decision-makers' past experience, management expectations, national export policies and industry characteristics are among them. By demonstrating the importance of learning and evolution (Lam and White 1999), the I-models provide a clear understanding of the firms' internationalization process (Crick 1995; Moen and Servais 2002). Unlike the U-model, they demonstrate the importance of the firms' managers for their internationalization (see Table 2). As it was concluded from Appendix 1, these models also include several other foreign market entry modes besides the ones introduced in the Uppsala model. In addition, the authors of the I-models have synthesized several internationalization concepts, used different analytical methods and given advice for tailoring export stimulation programs (Leonidou and Katsikeas 1996; see also Table 4).

On the other hand, the I-models have been relatively often criticized for being static (Leonidou and Katsikeas 1996) and deterministic (Reid 1983), providing only a partial explanation of the export development process (Moen and Servais 2002; Sullivan and Bauerschmidt 1990), having limited geographical and industrial scope (for example, neglecting service-based companies) and under-emphasizing (but not excluding) the importance of individuals' strategic choices and the companies' resources (Leonidou and Katsikeas 1996; Turnbull 1987). In addition, the models are based on a relatively limited amount of empirical work (Moen and Servais 2002), do not explain or predict the firms' movement from one stage to the next (Andersen 1993; Gankema et al. 2000) and are mainly concentrated on exports (Gankema et al. 2000). In the beginning, only a couple of authors (Bilkey 1978, Cavusgil 1980 and Reid 1983) considered the possibility of licensing and foreign affiliates. In addition, as it can be concluded from the **Appendix 1**, since the middle of 1990s, this type of research has not been carried out so extensively as before.

Table 4. The importance and limitations of innovation- related internationalization models

Importance	Limitations
Provide a clear understanding of the internationalization process and the variables influencing it.	Relatively stagnating importance.
Help to tailor export stimulation programs.	Based on a limited amount of empirical work.
Show the importance of individual learning, top managers and incremental decisions.	Relatively similar to each other.
Accepted in the international business literature. Received considerable empirical support.	Provide only a partial explanation of the export development process.
Synthesize various theoretical concepts and use relatively sophisticated analytical methods.	Limited geographical scope; ignore some industries and firm types.
	Mostly concentrate on exports.
	Do not explain or predict firms' movement from one stage to the next.
	Mostly static and deterministic in nature. Leave no strategic choices for individuals.
	Offer almost no managerial advice.

Sources: Andersen 1993; Andersson 2000; Barrett and Wilkinson 1985; Bilkey 1978; Crick 1995; Fina and Rugman 1996; Gankema et al. 2000; Lam and White 1999; Leonidou and Katsikeas 1996; McAuley 1999; Moen and Servais 2002; Morgan and Katsikeas 1997; Reid 1983; Sullivan and Bauerschmidt 1990; Turnbull 1987

2.10 .3 -The Finnish model, analyzes various dimensions of internationalization: for example, sales objects, firm and decision-maker characteristics and firm competencies (see Figure 3). Thus, it proposes a broader framework for the evaluation of internationalization than the U- and I-models (see Table 7) they concentrated on markets and foreign operation methods. The model also complements the two previous models (Chetty 1999; Petersen and Welch 1999) as it includes less conventional entry modes (for example, contract manufacturing and project exporting). Moreover, it suggests that firms can de- and re-internationalize and internationalize in some dimensions more than the others. In addition, it can explain movements from one stage in the internationalization process to another (that the I-model was incapable of) and deviations from the patterns expected by traditional internationalization models (Karlsen et al. 2003). The Finnish model has also received empirical support (Korhonen 1999). In addition, it focuses on inward internationalization and draws important governmental implications. Consequently, it overcomes several weaknesses of the previous two models (Chetty 1999; Korhonen 1999; Welch and Luostarinen 1993).

Table 5. The importance and limitations of the Finnish model

Importance	Limitations
• Based on a substantial empirical sample. • Proposes a broader framework for evaluating internationalization than the U- and I-models. • Looks at a firm's internationalization along various dimensions and implies that in some dimensions, it can be more international than the others. • Includes exogenous variables. • Includes leapfrogging. • Admits de- and re-internationalization. • Includes less conventional market entry modes: for example, licensing, assembling subsidiaries and cooperative modes. • Turns attention to the role of inward activities and shows their links with outward operations. • Draws important governmental implications, shows the importance of promoting inward activities.	• Has attracted less attention than the U- and I-models. • Little empirical evidence on inward-outward connections. • Has ignored some dimensions of internationalization. • Does not concentrate on the context where interactions are emerging and developing. • Does not show how companies could speed up their internationalization process. • Does not show what factors inhibit switching from one market operation mode to another. • Does not include the history of the enterprise and its founders. • Pays little attention to service firms and large companies. • Does not study different connections in MNCs. • Does not give many suggestions how to promote inward internationalization.

Sources: Arenius 2002; Chetty 1999; Fletcher 2001; Freeman 2002; Gabrielsson et al. 2002; Jaklič 1998; Jones 1999, 2001; Korhonen 1999; Luostarinen 1994; Luostarinen and Welch 1997; Pedersen et al. 2002; Petersen and Welch 1999; Petersen et al. 1999; Welch and Luostarinen 1993

While the importance of the Finnish model has been emphasized in several studies, it has also received some criticism (see Table 5). The model has attracted less attention in the literature than the U-and I-models (Jones 1999). This can be partly explained by the

fact that Reijo Luostarinen has not published extensively outside Finland. The Finnish model also does not study connections in the multinationals (Korhonen 1999), pays little attention to service firms (Freeman 2002), some dimensions of internationalization (Chetty 1999) and the history of the company and its founders (Jones 2001). Moreover, it does not show how enterprises could quicken their internationalization process (Korhonen 1999), what factors inhibit them from switching from one market operation mode to another (Petersen and Welch 1999), what should be done to promote inward internationalization: for example, importing (Korhonen 1999) and how exactly this could stimulate outward internationalization (Fletcher 2001).

In conclusion, all the three approaches (especially, the first two) have received general acceptance and considerable empirical support in the international business literature. They all provide a clear understanding of the internationalization process, but from a somewhat different perspective. The U-model emphasizes the importance of knowledge and previous business experience in the firms' internationalization. The I-models demonstrate the relevance of several other important factors. The Finnish model identifies a large number dimensions for evaluating this process. While the first two research streams are especially suitable for the earlier stages of international development (indirect and direct exporting), the Finnish model includes less conventional entry modes and turns attention to inward internationalization. It also suggests that firms can de- and re-internationalize and "leapfrog" some stages during their international development.

On the other hand, the first two approaches have been often criticized for being too deterministic (the I-models also being static), providing only a partial explanation of the internationalization process, not including all foreign market entry modes and not explaining why and under what conditions firms move from one stage to the next. Both the U- and the Finnish model under-emphasize the importance of individuals: managers and founders. In addition, all the three models are less suitable for service companies and offer little managerial advice: for example, how to quicken the internationalization process. Moreover, they do not demonstrate the impact of (foreign owners') networks on the enterprises' internationalization. This will be done below.

2.11 - The impact of (foreign owners') networks on internationalization

In this subchapter, we will mostly concentrate on the network approach to internationalization. Some material from the other research streams — for example, the literature on the relationships between FDI and host country exports — is also included.

The network approach has been often applied to **internationalization**. This research stream has partly grown out of the Uppsala internationalization model.

Still, the other researchers and research streams should also be mentioned in this research area. For example, several scholars have demonstrated the importance of networks while studying foreign direct investments abroad as a market entry mode (Bridgewater 1999; Chen and Chen 1998; Ghauri and Holstius 1996; Salmi 2000) and analyzing the impact of inward FDI on foreign affiliates' internationalization (Hunya 1998; Kaminski and Smarzynska 2001).

While traditional literature largely concentrates on the processes of deciding and planning to enter a market and on entry modes, the network approach stresses the actual process of market entry and becoming a player in the network (Salmi 2000). From this point of view, an enterprise's internationalization means establishing and developing

business relationships in networks in other countries (Johanson and Mattson 1988). Consequently, a company's progress and route towards internationalization depend on its total business network (Axelsson and Johanson 1992). This means that not only direct partners, but also the ones of their partners affect a firm's behavior (Ford 1998). The existing relationships, in turn, can be used as bridges to other networks (Sharma and Johanson 1987; Johanson and Vahlne 1990).

From the network perspective, the international business enterprise may, but does not necessarily, have subsidiaries in several countries — it may well consist of one single company engaged in international business relationships (Andersson and Johanson 1997). Consequently, a firm can have most of its physical assets located domestically but still be an important player in an international network). It can also gain access to the other enterprises' experiential knowledge without necessarily going through the same experiences (Eriksson et al. 1998). In addition to learning about the partner's capabilities, needs and strategies, a company learns about the latter's business conditions and market networks (Johanson and Johanson 1999). Thus, a typical internationalization sequence has changed from gradual expansion to expansion in leaps by joining the nets (Hertz 1996).

The relationships with clients, competitors, colleagues, government and friends may also affect the firm's choice of foreign market and entry mode (Coviello and Munro 1997; Coviello and Martin 1999; Johanson and Vahlne 2003). Network relationships might be instrumental in explaining why some firms choose to enter a market directly with their own manufacturing unit (Eklund 1996) and not start from exporting as the U- and I-models suggest. On the other hand, it should not be forgotten that the relationships could not only drive and facilitate, but also inhibit a firm's internationalization (Ford 1998).

From the network perspective, the internationalization process is an outcome of interplay between experiential knowledge development and commitment although they concern potential and existing relationship partners, not countries (Johanson and Vahlne 2003). Internationalization of the firm can be achieved through the establishment of relationships in foreign country networks that are new to the firm (international extension); the development of relationships and increasing resource commitments in those networks in which the company already has a position (penetration) or connecting existing networks in different countries (Johanson and Mattson 1988). The experienced enterprises can use their existing network position as a base for further internationalization — for instance, FDI (Forsgren 1990). Foreign market entry is achieved when the firm has developed one or a set of exchange relationships in the foreign market, constituting a basis to continue a business there for a long term. In other words, it has realized a position in the new network where it plays a role accepted by the others, has a certain amount of trust and has achieved a certain volume at which the business at least breaks even (Blankenburg 2001). This process depends on several internal and external factors (see Figure 6).

Foreign market entry is more successful in the following conditions (Blankenburg 2001).

- The degree on conflicting interests is low.
- The company is visible for the other network actors.
- External network actors are active and share the interests of the entrant.
- The actors have many activities in foreign markets.
- The network is tightly structured.
- The firm's managers have similar ideas concerning its development.
- There is sufficient network knowledge.
- An enterprise is linked with other international actors, especially those on the market it wants to enter.

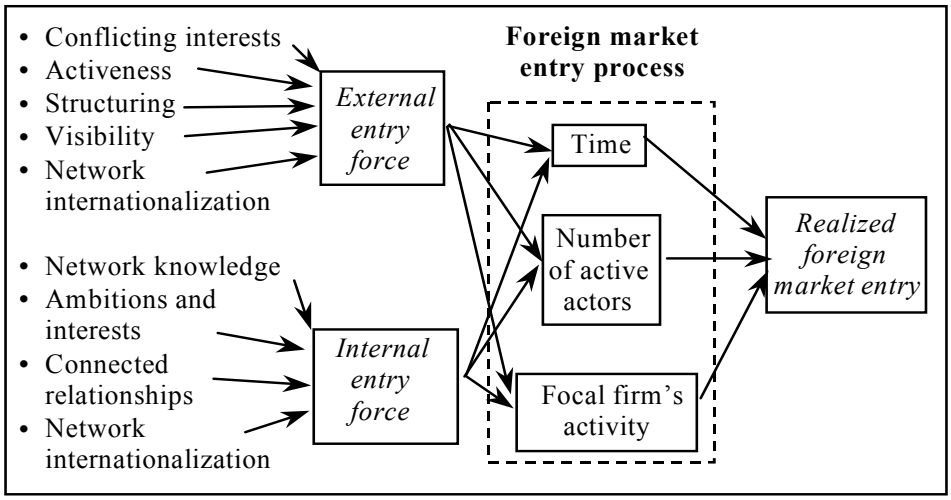

Figure 6. Forces affecting the entry process and the realized foreign market entry (Source: based on Blankenburg 2001)

From the network perspective, firms can be divided into four groups depending on their and their environment's internationalization (see Table 6).

Table 6. The internationalization typology of firms and networks

		Degree of internationalization of the market (the production net)	
		Low	High
Degree of internationalization of the firm	Low	*The early starter*: the firm, its competitors and suppliers have few important international relationships.	*The late starter*: the market is already internationalized. The company has indirect relationships with foreign business networks through its suppliers, customers and competitors.
	High	*The lonely international*: the enterprise is already highly internationalized but the market environment still has a domestic focus.	*The international among others*: the firm and its environment are both highly internationalized. The company is connected to various international networks that provide opportunities for obtaining external resources.

Sources: based on Chetty and Blankenburg Holm 2000 and Johanson and Mattson 1988

1. In the case of a lonely international, the enterprise has experience of relationships with and in foreign countries. It has acquired knowledge and means to handle environments differing with respect to culture, institutions and the other dimensions (Johanson and Mattson 1988). Consequently, failures are less likely. The lonely international alone has the capabilities to promote internationalization of the market (Chetty and Blankenburg Holm 2000). It may work with suppliers to upgrade inputs and thereby enhance their competitiveness. The members of the ancillary network[5] are only indirect exporters (Wilkinson et al. 2000).

2. In the case of an international among others, a further internationalization of the firm only means marginal changes in extension and penetration. The company has possibilities to use positions in one net for bridging over the other nets (Johanson and Mattson 1988), for example, penetrating the third countries. An important issue for this type of an enterprise is co-ordination of activities in different markets (Andersson 2002). In this situation, externalization may occur: the company may increasingly purchase components and sub-assemblies rather than do the manufacturing itself (Johanson and Mattson 1988). The members of the primary and ancillary network also belong to highly internationalized networks. This is important for three main reasons (Wilkinson et al. 2000).

- If the international competitiveness of primary enterprises starts to run out, the input network can still remain internationally competitive.

- In this case, it is generally easier for internationalized firms to switch to non-domestic based suppliers than in the lonely international situation.
- An important part of international trade is linked to big projects for which companies or consortia are invited to bid. The choice of suppliers to such projects is often influenced by the nationality of the main contractor and by the financial conditions offered. It is easier for a main contractor or consortium from a particular country to have a high content from that country if the ancillary network is also internationally competitive.

3. If the suppliers, customers and competitors of the firm are international, even the purely domestic company has a number of indirect relations with foreign networks (Johanson and Mattson 1988). Relationships in the domestic market may be the driving forces to enter foreign markets. The late starters *'* internationalization may be also led by indirect relationships with foreign business networks. Markets with

close psychic distance, however, might be difficult to enter, so the firm might start its internationalization by entering more distant markets. The late starters are at a disadvantage because their competitors have more knowledge and because it is hard for new entrants to break into an existing network (Chetty and Blankenburg Holm 2000). There are several reasons why they do not try to internationalize (Wilkinson et al. 2000).

- The nature of the input could be of little significance in contributing to the international competitiveness of other firms in the primary or ancillary network.
- Specific barriers might exist to trade for the products, such as government prohibitions.
- There might still be enough growth opportunities in the domestic market.
- These companies might not be internationally competitive or aware of international opportunities.

4. The early starters are different from the late starters in that other members of the ancillary network or the part of the primary network served are not internationalized (Wilkinson et al. 2000). The firms have little knowledge of foreign markets and they cannot count upon utilizing relationships in the domestic market to gain such knowledge (Johanson and Mattson 1988). Consequently, these companies' internationalization should be most similar to the one proposed in the Uppsala model (Arenius 2002). Generally, for these enterprises, the same reasons for concentrating on the home market exist as for the late starters, but there are two important differences. First, there may not be many international firms of this type anywhere: for example, their product or service might not be tradable (like wholesaling and retailing). Hence they are only exported, embodied in other products or services. The second difference from the late starters is that, should these companies start to export, they may not meet internationally active competitors or customers, unless the domestic industry had been isolated from international trade (Wilkinson et al. 2000).

Since the early starters are pioneers, it is likely that management attitude to exporting is positive and that knowledge of internationalization is limited (Wilkinson et al. 2000). They may also have little opportunity to acquire this knowledge from their relationships in the domestic market (Hinttu et al. 2002). Consequently, the enterprises use agents, distributors or customers abroad to internationalize, reduce cost and uncertainty and benefit from the agent's previous knowledge and investments in that market. The initiative to go abroad is often taken by other counterparts than the firm itself. The alternative strategy, to start with an acquisition or "greenfield" investment, is

mainly possible for the companies that are large and resourceful in the home market (Johanson and Mattson 1988). When the enterprise gradually becomes more internationalized it will move into another phase, the lonely international.

Substantial research has also been made in the **relationships between FDI and host country exports**. Some conclusions of this research stream can be useful for examining the impact of foreign owners' networks on the foreign-owned firms' internationalization. Several authors have shown that foreign affiliates usually export more than local-capital-based enterprises.[6] There is such evidence, for example, from Estonia (Varblane and Ziacik 1999; Vissak 2001ab), the Czech Republic, Slovakia (Hunya 1998), Hungary (Hooley et al. 1996; Hunya 1998; Kaminski 1999), Poland (Kaminski and Smarzynska 2001; Kubielas 1996) and Slovenia (Rojec et al. 2000). This is caused by the following two reasons (Blomström 1990; Dunning 1994; Fan and Dickie 2000; Kaminski and Smarzynska 2001; Lall 1993; Lauter and Rehman 1999; Lipsey 2002; Rhee and Belot 1990; UNCTAD 1995, 2002; Zhang and Song 2000; WTO 1996).

- Foreign affiliates may have a better export potential than local firms because of their business contacts abroad, management and marketing skills, the right to use their parents' brand names, superior technology and greater general know-how.
- The owners can also help the affiliates to set up a distribution network, follow consumer tastes, industrial norms and safety standards; deal with product design, packaging, distribution, servicing and shaping a new product image.

From the **industrial organization approach**, we can reach a similar conclusion. Multinational enterprises could possess some advantages, compared to local firms (or subsidiaries): for example, technology, management or marketing skills, cost effectiveness, established market or financial strength (Hymer 1960, 1968, 1976; Kindleberger 1969). Consequently, from the foreign owner, the foreign-owned company may acquire capital and a bundle of proprietary and intangible assets, including technology, business techniques, skilled personnel and market channels (Caves 1996; Fan and Dickie 2000; Hymer 1976). Several positive impacts of FDI on host country enterprises' exports — for example, receiving skills, improving labor quality and increasing exports — have been also demonstrated in the **"flying-geese" model** (Kojima 1975, 1978, 1985, 1986, 2000).

Five conclusions can be drawn from the above. First, through linking into their foreign owners' networks, the affiliates may acquire capital, technology, business techniques, skilled personnel and access to market channels. Second, by joining a foreign (parent company's) business network, a firm can considerably quicken its internationalization. Third, by linking into a network, a company might start its internationalization by entering more distant markets. Fourth, as through networking, enterprises can obtain access to the other firms' knowledge, they can skip some stages of their internationalization process: for example, enter a market directly with their own manufacturing units. Fifth, besides driving or facilitating a firm's internationalization, network relationships sometimes also inhibit it.

2.12 Methods of Acquisition

Companies may: use their resources for FDI, or acquire existing companies abroad, and build a new company abroad. Resources for Acquisition: FDI usually is an international capital movement

Investor may transfer other assets to effect an FDI, also company may use funds it earns in a foreign country to establish an investment and can trade equity with companies in other countries; Reasons for buying: does not add further capacity to the market, avoiding start-up problems, easier financing. And reasons for building as no desired company is available for acquisition, acquisition will carry over problems and acquisition is harder to finance.

Relationship of Trade and Factor Mobility: FDI requires the movement of various production factors, here we can say the Trade theories and factor mobility: Factor movement is an alternative to trade, may or may not result in more efficient allocation of resources. FDI a major cause and means of factor movement. Substitution inability to use foreign production factors may stimulate efficient methods of substitution, when factor proportions vary across countries; pressures arise for the most abundant factors to move to an area of scarcity, Restrictions make factor movements only partially mobile internationally, lowest costs occur when trade and production factors are both mobile, also Many exports would not occur if overseas investments did not exist: factor mobility via FDI often stimulates trade because of the need for: components, complementary products, equipment for subsidiaries: Relationship of FDI to companies: FDI may be more risky than some other forms of IB, Businesses and governments are motivated to engage in FDI in order to: expand sales, acquire resources, minimize competitive risk, Governments may use FDI for political objectives

2.12. 1 Risk Minimization

Following customers—company can keep customers by following them abroad

Indirect exports—domestic good is embodied in a product that the domestic customer exports

indirect exporters commonly follow their customers when they make direct investments

Preventing competitors' advantage—company's decision to invest depends not so much on the benefits it gains but rather on what it could lose by not entering the field

Oligopolistic industries—investors often establish facilities in a given country at about the same time.Companies experience capacity-expansion cycles concurrently

Face changes in import restrictions or market conditions that make FDI advisable

Political motives: Governments give incentives to their companies to make direct investments in order to gain supplies of strategic resources develop spheres of influence

2.13 Advantages of FDI

Monopoly advantages before direct investment

Companies invest directly only if they think they hold some supremacy over similar companies in countries of interest

monopoly advantage—results from a foreign company's ownership of some resource unavailable at the same price or terms to the local market companies enjoy monopoly advantage if they can borrow capital at a lower interest rate than companies from another country, and if their home-country's currency has high buying power; Advantages after direct investment Selling internationally is efficient; Spreads the costs of operations

2.14- Direct Investment Patterns
Location of ownership for worldwide FDI; almost all ownership is by companies from developed countries emerging economy ownership is increasing Location of investment Most FDI occurs in developed countries because they have the biggest markets lowest perceived risk least discrimination toward foreign companies Economic sector of investment; FDI in raw materials has declined; FDI in manufacturing has stabilized FDI in service sector and technology-intensive manufacturing has grown rapidly

2.15 -International Strategic Alliances

Cooperative agreements among competitors from different countries
Advantages: Facilitate entry into a foreign country; Allow sharing of fixed costs of new products processes; Bring together complementary skills and assets that can not easily be developed independently; Help establish industry standards in technology; Reduce operating costs,e.g., shared training, purchasing
Disadvantages: give competitors new technology / markets at low cost; Disproportional benefit accrual to partners.

2.16 -Foreign Direct Investment in the World Economy
The flow of FDI refers to the amount of FDI undertaken over a given time period
The stock of FDI refers to the total accumulated value of foreign owned assts at a given time; the outflows of FDI refer to the flow of FDI out of a country; the inflows of FDI refers to the flow of FDI into a country

2.17 - Trends in FDI
Flow and stock increased in the last 20 years
In spite of decline of trade barriers, FDI has grown more rapidly than world trade because Businesses fear protectionist pressures; FDI is seen a a way of circumventing trade barriers Dramatic political and economic changes in many parts of the world Globalization of the world economy has raised the vision of firms who now see the entire world as their market

2.18 – Slumping FDI
Between 200 and 2004 the value of FDI slumped almost 50% from $1.2 trillion to about $620 billion; the slowdown in FDI flows has been most pronounced in developed nations The slowdown is probably temporary and reflects three developments; General slowdown in the growth rate of the world economy; Heightened geopolitical uncertainty following the September 11, 2001 attack; Bursting of the stock market bubble in the US

2.19 -The Direction of FDI

Historically, most FDI has been directed at the developed nations of the world as firms based in advanced countries invested in other markets; The US has been the favorite target for FDI inflows; While developed nations still account for the largest share of FDI inflows, FDI into developing nations has increased and Most recent inflows into developing nations have been targeted at the emerging economies of South, East, and Southeast Asia Gross fixed capital formation summarizes the total amount of capital invested in factories, stores, office buildings, etc.This makes FDI an important source of capital investment and a determinant of the future growth rate of an economy

2.20 -The Form of FDI
Greenfield operation: Mostly in developing nations
Mergers and acquisitions: Quicker to execute. Foreign firms have valuable strategic assets. Believe they can increase the efficiency of the acquired firm. More prevalent in developed nations

2.21 -The Shift to Services
The shift to services is being driven by four factors:
Reflects the general move in many developed economies away from manufacturing and toward service industries; Many services cannot be traded internationally; Many countries have liberalized their regimes governing FDI in services; The rise of Internet-based global telecommunications networks has allowed some service enterprises to relocate some of their value creation activities to different nations to take advantage of favorable factor costs

2.22 -Horizontal FDI
Horizontal Direct Investment: FDI in the same industry abroad as company operates at home: FDI is expensive because a firm must bear the costs of establishing production facilities in a foreign country or of acquiring a foreign enterprise; FDI is risky because of the problems associated with doing business in another culture where the rules of the game may be different

2.23 -Market Imperfections
Market imperfections are factors that inhibit markets from working perfectly In the international business literature, the marketing imperfection approach to FDI is typically referred to as internalization theory With regard to horizontal FDI, market imperfections arise in two circumstances:
When there are impediments to the free flow of products between nations which decrease the profitability of exporting relative to FDI and licensing.
When there are impediments to the sale of know-how which increase the profitability of FDI relative to licensing

2.24 -Horizontal FDI – When
Transportation costs for a product are high
Market Imperfections (Internalization Theory)
Impediments to the free flow of products between nations
Impediments to the sale of know-how
Follow the lead of a competitor - strategic rivalry
Product Life Cycle - however, does not explain when it is profitable to invest abroad
Location specific advantages (natural resources)

2.25 -Vertical FDI
Vertical FDI takes two forms
Backward vertical FDI is an investment in an industry abroad that provides inputs for a firm's domestic production processes
Forward vertical FDI occurs when an industry abroad sells the outputs of a firm's domestic production processes, this is less common than backward vertical FDI

2.26 -Strategic Behavior

One explanation for firm's choice of vertical FDI is that by using vertical backward integration, a firm can gain control over the source of raw materials
This would allow the firm to raise entry barriers and shut new competitors out of an industry
Another explanation of vertical FDI is that firms use this strategy to circumvent the barriers established by firms already doing business in a country

2.27 -Market Imperfections
The market imperfections approach offers two explanations for vertical FDI
There are impediments to the sale of know-how through the market mechanism
Investments in specialized assets expose the investing firm to hazards that can be reduced only through vertical FDI

2.28 -The Benefits of FDI to Host Countries
Four main benefits of FDI for a host country: Resource-transfer effect. Employment effect. Balance-of-Payments effect. Effect on competition and economic growth, in a free market view; Economists argue that the benefits of FDI so outweigh the costs associated with pragmatic nationalism that it is misguided; the best policy would be for countries to forgo all intervention in an MNE's investment decisions

Resource-Transfer Effects: FDI can make a positive contribution to a host economy by supplying, Capital, technology and Management.

Employment Effects: Brings jobs that otherwise would not be created, direct: Hiring host-country citizens and Indirect: Jobs created by local suppliers, Jobs created by increased spending by employees of the multi-national enterprise, so the effects of FDI on employment are both direct and indirect. Direct effects arise when a foreign MNE employs a number of host-country citizens. Indirect effects arise when jobs are created in local suppliers as a result of the investment and when jobs are created because of increased local spending by employees of the MNE. The indirect employment effects are often as large as, if not larger than, the direct effects. The question always remains about the true number of net jobs created or lost however.

Balance-of-Payments Effects
Balance-of-Payments Accounts are divided into two main sections, the current account records transactions that pertain to three categories: merchandise goods, services, and investment income the capital account records transactions that involve the purchase or sale of assets, current account deficits occur when a country imports more goods, services, and income than it exports, current account surpluses occur when a country exports more goods, services, and income than it imports

Host country benefits from initial capital inflow when MNC establishes business. Host country records current account debit on repatriated earnings of MNC. Host country benefits if FDI substitutes for imports of goods and services. Host country benefits when MNC uses its foreign subsidiary to export to other countries.

Effect on Competition and Economic Growth
Greenfield investments increases the amount of competition, which can: drive down prices, Increase the economic welfare of consumers, increased competition tends to stimulate

capital investments, Long-term results may include, Increased productivity growth, Product and process innovations, Greater economic growth

Costs of FDI to Host Countries
Adverse effects on competition. Adverse effects on the balance of payments. After the initial capital inflow there is normally a subsequent outflow of earnings, Foreign subsidiaries could import a substantial number of inputs. National sovereignty and autonomy, some host governments worry that FDI is accompanied by some loss of economic independence resulting in the host country's economy being controlled by a foreign corporation

2.29 - Benefits of FDI to the Home Country
Improves balance of payments for inward flow of foreign earnings. Creates a demand for exports.
Export demand can create jobs. Increased knowledge from operating in a foreign environment
Benefits the consumer through lower prices. Frees up employees and resources for higher value activities

Costs of FDI to the Home Country
Can drive out local competitors or prevent their development. Profits brought home 'hurt' (debit) a host's capital account. Parts imported for assembly hurt trade balance. Can affect sovereignty and national defense

2.30 -Home Country Policies and FDI
To encourage outward FDI: Government backed insurance programs to cover foreign investment risk .Capital assistance. Tax incentives. Political pressure. Restricting Outward FDI. Limit capital outflows out of concern for the country's balance of payments. Tax incentives to invest at home. Prohibit national firms from investing in certain countries for political reasons

2.31 -Host Country Policies and FDI
Encouraging Inward FDI: Offer government incentives to foreign firms to invest, Tax concessions, Low interest loans, Grants/subsidies

Restricting Inward FDI, Ownership restraints: Foreign firms are prohibited to operate in certain fields. Foreign ownership is allowed but a significant proportion of the equity must be owned by local investors. Performance requirements that control the behavior of the MNE's local subsidiary

2.32 -Which Foreign Markets
The choice must be based on an assessment of a nation's long-run profit potential. The attractiveness of a country depends upon balancing the benefits, costs, and risks associated with doing business in that country. Benefits include: Size of market. Present wealth of the consumers in the market. Likely future wealth of consumers. Economic growth rates

2. 33Timing the Entry
Advantages frequently associated with entering a market early are commonly known as first-mover advantages, the ability to preempt rivals and capture demand by establishing a strong brand name.

Ability to build sales volume. Ability of early entrants to create switching costs. Disadvantages associated with entering a foreign market before other international businesses are referred to as first-mover disadvantages, Pioneering costs are costs that an early entrant has to bear, Possibility that regulations may change

2.34 -Scale of Entry
Large scale entry: Strategic Commitments - a decision that has a long-term impact and is difficult to reverse, may cause rivals to rethink market entry, may lead to indigenous competitive response. Small scale entry. Time to learn about market, Reduces exposure risk

2.35 Entry Modes: Firms can use six different methods to enter a market, Exporting, Turnkey Projects, Licensing, Franchising, Joint Ventures, Wholly Owned Subsidiaries

2.35 -1 Exporting
Advantages: Avoids cost of establishing manufacturing operations. May help achieve experience curve and location economies
Disadvantages: May compete with low-cost location manufacturers. Possible high transportation costs. Tariff barriers. Possible lack of control over marketing reps
2.35 .2- Turnkey projects: (Contractor agrees to handle every detail of project for foreign client)
Advantages: Can earn a return on knowledge asset. Less risky than conventional FDI
Disadvantages: No long-term interest in the foreign country. May create a competitor. Selling process technology may be selling competitive advantage as well

2.35. 3- Licensing: Agreement where licensor grants rights to intangible property to another entity for a specified period of time in return for royalties.

Advantages: Reduces development costs and risks of establishing foreign enterprise. Lack capital for venture. Unfamiliar or politically volatile market. Overcomes restrictive investment barriers. Others can develop business applications of intangible property.

2.36. 4- Franchising: Franchiser sells intangible property and insists on rules for operating business
Advantages: Reduces costs and risk of establishing enterprise
Disadvantages: May prohibit movement of profits from one country to support operations in another country. Quality control

2.37. 5- Joint Ventures:
Advantages: Benefit from local partner's knowledge. Shared costs/risks with partner. Reduced political risk.
Disadvantages: Risk giving control of technology to partner. May not realize experience curve or location economies. Shared ownership can lead to conflict

2.38. 6 - Wholly Owned Subsidiary: Subsidiaries could be Greenfield investments or acquisitions
Advantages: No risk of losing technical competence to a competitor. Tight control of operations. Realize learning curve and location economies
Disadvantage: Bear full cost and risk

2.39- Core Competencies and Entry Mode
The optimal entry mode for firms depends to some degree on the nature of their core competencies, a distinction can be drawn between firms whose core competency is: technological know-how, management know-how, the greater the pressures for cost reductions are, the more likely a firm will want to pursue some combination of exporting and wholly owned subsidiaries; technological Know-How: Licensing and joint-venture arrangements should be avoided if possible; should probably use a wholly owned subsidiary. Exceptions include, an arrangement can be structured to reduce the risk of licensees, If the technological advantage is only transitory; management Know-How: the firms' valuable asset is normally a brand name. The result is that franchising and subsidiaries are very attractive. Often times a joint venture is politically more acceptable

2.40 -Acquisitions Pros and Cons:
Pro: Quick to execute. Preempt competitors. Possibly less risky
Con: Disappointing results. Overpay for firm.; optimism about value creation (hubris). Culture clash. Problems with proposed synergies

2.41 -Greenfield Ventures Pros and Cons
Pro: Can build subsidiary it wants. Easy to establish operating routines
Con: Slow to establish. Risky. Preemption by aggressive competitors

2.42 -Acquisition or Greenfield:
Acquisitions are attractive if: there are well established firms already in operation. Competitors want to enter the region. Greenfield ventures are attractive if: there are no competitors. Competitors have a competitive advantage that consists of embedded competencies, skills, routines, and culture.

2.43 - Strategic Alliances: Cooperative agreements between potential or actual competitors
Advantages: Facilitate entry into market. Share fixed costs. Bring together skills and assets that neither company has or can develop. Establish industry technology standards
Disadvantages: Competitors get low cost route to technology and markets

2.44 - Alliances are popular: High cost of technology development. Company may not have skill, money or people to go it alone. Good way to learn. Good way to secure access to foreign markets. Host country may require some local ownership

2.45 - Global Alliances are Different
Firms join to attain world leadership. Each partner has significant strength to bring to the alliance; A true global vision. Relationship is horizontal not vertical. When competing in markets not part of alliance, they retain their own identity

2.46 - Partner Selection
Get as much information as possible on the potential partner. Collect data from informed third parties, Former partners, Investment bankers. Former employees. Get to know the potential partner before committing

2.47 Country Evaluation and Selection
Companies lack resources to take advantage of all international opportunities. Choice of where to operate an important business strategy, appealing countries are those with similar economic, political, cultural, and geographic conditions, Companies must: determine the order of entry into potential countries, set the allocation of resources and rate of expansion among countries; choosing Marketing and Production Sites and Geographic Strategy**:** companies must determine where to market and where to produce. Decisions on market and production locations may be highly interdependent, and the Process of determining overall geographic strategy must be flexible: Country conditions change and the Plan must allow company to: respond to new opportunities. Withdraw from less-profitable operations. Managers can use several geographic strategies, and the company can making a Scan for Alternatives, Scanning techniques based on broad variables indicate opportunities and risks, Without scanning a company may: overlook opportunities. Examine too many possibilities. Cost of too many studies may erode profits. Choose and Weight Variables. Environmental climate: conditions in a host country that could affect success of foreign enterprise opportunities: determined by revenues less costs, and market size and sales potential most important. Managers may have to estimate current demand, indicators of market size and future sales, GNP per capita income growth, population growth rates, level of industrialization. Ease and compatibility of operations, companies are attracted to countries that are located near by share the same language, share similar legal, cultural, and economic systems. escalation of commitment: the greater the investment in examining a foreign investment opportunity, the more likely it will be accepted, regardless of its merit, companies often limit consideration of proposals to countries that: offer size, technology, and other factors familiar to company personnel, allow acceptable percentage of ownership permit sufficient profits to be remitted. Costs and resource availability, and Companies go abroad to secure resources that are unavailable at home; also companies must consider a variety of costs of factors of production.

2.48 -Trade-offs between labor costs and capital intensity:
Companies with rapidly evolving technologies try to locate production close to product-development activities. Companies need to be near suppliers and customers. Corporate tax rates on income affect location decisions, and cost comparisons among countries difficult complicated by technology differences. Red tape: increases operating costs. Degree of red tape is not directly measurable. Subjective evaluation is necessary. Risks: most investors prefer certainty to uncertainty, given the same expected return. Return on investment (ROI)—average of the various returns deemed possible for investments. Greater uncertainty increases investor's requirements for ROI. Insurance may reduce company's risk. Foreign investments generally have greater risk than domestic investments, also less familiar with foreign environments; and liability of foreignness—foreign companies have a lower survival rate than local companies

2.49- Competitive risk—company's innovative advantage may be short lived, Initiation lag—strategy for exploiting temporary innovative advantage. Companies may try to find countries in which significant competition is least likely. Advantages of locating where competitors are: competitors bear costs of evaluating location. Competitors attract suppliers and personnel. Competitors attract buyers. Clusters of competitors may provide access to information about new developments
2.50 -Monetary risk—must estimate country's monetary situation and predict future exchange rates and controls. Liquidity preference—investors want some holdings to be liquid, even with lower returns

2.51 - Political Risk: due to changes in political leaders' opinions and policies, civil disorder, and animosity between host and home countries, may result in property takeovers, damaged property, disrupted operations, and changed rules governing business. Companies assess political risks based on: past patterns of political risk, foreign investors may be compensated for asset takeover or property damage, examination of governmental decision makers, cross-section of opinions, use of expert analysts, examination of countries' social and economic conditions, frustration among local populace may cause disruptions in business, companies undertake business research to reduce uncertainties in the decision process. Narrow the alternatives they consider. Assess the merits of their existing programs. Must compare the cost of information with its value.

2.52 Opportunity-risk matrix—used to: Decide on indicators and weight them. Evaluate each country on the weighted indicators. Plot to see relative placements. Key element is the projection of the future country location.
Country attractiveness-company strength matrix: Highlights the company's product advantage country by country, Must be used with caution.
Environmental scanning—the systematic assessment of external conditions that might affect a company's operations, MNEs conduct scanning continuously, sophisticated companies tie scanning to the planning process

2.53 - Allocating among Locations:
Reinvestment decisions—involve replacing depreciated assets or adding to the existing stock of capital, most of the value of a foreign investment comes from reinvestment. once committed to a locale, company may not have option to move its assets elsewhere. Experienced personnel in a country best judges of what is needed in the locale. May be delegated certain investment decisions
Harvesting (divesting)—advisable when investment outlook is better in other countries
Reduces commitments in countries with poorer performance outlooks, ought to be planned
Takes place by selling or closing facilities, government may require performance contracts that make divestment difficult.
Interdependence of locations—profit figures from individual operations may obscure the real impact those operations have on overall company activities, also difficult to ascertain returns from subsidiaries, sales and purchases of subsidiaries may be made from and to units of parent company
Diversification strategy—company moves into many foreign markets, increasing commitments within each.
Concentration strategy—company moves to only one or a few foreign countries until it develops a strong involvement and competitive position there
Making Final Country Selections: most companies examine proposals one at a time: Proposal accepted if it meets minimum threshold criteria, Proposal comparison limited by time and cost.

2.54 - Governmental Attitudes toward Foreign Direct Investment
Multinational enterprises (MNEs) operate largely through foreign direct investment (FDI) Governmental policies encourage and restrict MNE operations. MNEs may not be concerned about interests of nations in which they operate. Very large MNEs are especially worrisome. Have considerable negotiating power. Executives frequently deal directly with heads of state to negotiate terms under which the MNE can operate. Pressure groups push to restrict MNEs' activities at home and abroad

2.55 - Evaluating the Impact of FDI
Trade-offs among constituencies
Stakeholders—include stockholders, employees, customers, and society at large, in the short term the aims of these groups conflict and in the long term all of their aims must be achieved adequately or none will be attained. Also management must be aware of these interests and make appropriate trade-offs, must resolve cross-national controversies
Trade-offs among objectives: Actions of MNEs may affect a country's economic, social, and political objectives. Countries want a greater share of benefits from MNE activities. It is incorrect to assume that if one stakeholder gains, another must lose

Cause-effect relationships: it is extremely hard to determine whether societal conditions are caused by MNEs' actions. Technological developments, competitors' actions, and governmental policies encumber cause-effect analysis. Studied at the individual and aggregate level of analysis. Potential contributions of MNEs. Size of MNEs suggests that they can contribute to a wide range of country objectives. MNEs—account for most of the world's export of goods and services: create access to foreign exchange for purchase of imports, are major producers and organizers of technology

Growth and employment effects—not a zero-sum game because MNEs may use resources that were unemployed or underemployed, both home and host country may profit.
Home-country losses: foreign production displaces domestic production, transfer of technology, jobs are exported, wages decline.

3.56. - Home-country gains: MNE investment initiates local development, more optimal use of production factors, use of unemployed resources, upgrading of resource quality and competition forces local companies to become more efficient
Host-country losses: MNEs undermine local entrepreneurial drive, MNEs may attract best local resources; able to bid up prices when competing with local companies and absorb local capital.Local companies may decrease R&D spending. Purchase of local firms by foreign investors, FDI more likely to generate growth in the host country: when the product or process is highly differentiated. When the foreign investors have access to scarce resources. in the more advanced emerging economies.

2.57 - Political and Legal Impact of the MNE
Countries are concerned that MNEs will undermine sovereignty of host countries: MNEs act as foreign-policy instruments of their home-country government; MNEs are independent of any government. Dependent MNEs become pawns of host-country governments; Extraterritoriality—occurs when governments apply their laws to their domestic companies' foreign operations. Trade restrictions—U.S. attempts to apply the Trading with the Enemy Act to foreign subsidiaries of U.S. companies
Antitrust laws—U.S. acted against domestic firms' foreign investments when there has been concern about possible harm to U.S. consumers; U.S. Justice Department has acted ambiguously.

2.58 - Differences in National Attitudes toward MNEs
Host countries—policies toward MNEs vary over time: seldom completely restrictive or completely laissez-faire. Policies intended to attract investment and receive the most benefits from it.

2.59 - Host- and home-country concerns about MNEs: Are greater for MNEs with large international commitments and greater about large MNEs because of their greater potential impact on national economic and political objectives.
MNEs acquire reputations in one country that affect perceptions in other countries; modern communication has facilitated the spread of negative publicity about MNEs' practices
Companies must choose an international operating mode, many of which are collaborative
Collaboration frequently lessens control. MNEs with fully global orientation use most of the operational modes available, Strategic alliance—collaboration is of strategic importance to one or more of the companies, Collaborations—provide different opportunities and problems than do trade or wholly owned direct investment

2.60 - Motives for Collaborative Arrangements
Some of the motives for collaboration for domestic operations are both: the same for international operations, Different for international operations, each participating company has its own primary objective for international operations and its own motive for collaboration.

General Motives for Collaboration: Spread and reduce costs—sometimes it is cheaper to get another company to handle work, especially: At small volume can spread fixed costs. When the other company has excess capacity. Company handling production or sales may lower its average costs
Cooperative ventures may increase operating costs.

Specialize in competencies: resource-based view of the firm—holds that each company has a unique combination of competencies. Large, diversified companies realign to focus on their major strengths. Licensing can yield a return on a product that does not fit the company's strategic priority based on its best competencies. Avoid competition—when markets are too small, companies' band together so as not to compete. Companies may combine resources to combat larger competitors. Companies may collude to raise everyone's profits. Secure vertical links—companies may lack competence or resources to become fully vertically integrated. Secure horizontal links—may provide finished products or components. Gain market knowledge—learn about a partner's technology, operating methods, or home markets.

2. 61 - International Motives for Collaboration
Gain location-specific assets—collaboration with local firm used to deal with barriers encountered when operating abroad: Foreign companies may gain operational assets when teaming with local companies. Overcome legal constraints—country may require foreign companies to share ownership. Collaboration a means of protecting assets. hinders non associated companies from pirating the asset. Diversify geographically—can smooth its sales and earnings because business cycles differ. Minimize exposure in risky environments—reduce base of assets located abroad

Types of Collaborative Arrangements, forms of foreign operations differ in the: amount of resources committed to the operation. Proportion of resources located abroad. Type of collaborative arrangement selected may necessitate trade-offs among objectives. Companies with difficult-to-duplicate resource have a wider choice of operating form.

2.62 - Some Considerations in Collaborative Arrangements.
Desire for control over foreign operations: The greater reliance on collaboration, the greater the loss of control over decision making. External arrangements imply the sharing of revenues.
Prior expansion of the company abroad—may reduce some advantages of more foreign expansion

2.62.1 Licensing: Licenser grants rights to intangible property to licensee to use in a specified geographic area for a specified period, Licensee ordinarily pays a royalty to licenser, Intangible property includes patents, copyrights, trademarks, franchises, and methods or systems, Licensing often has an economic motive—the desire for faster start-up, lower costs, or access to additional resources
Cross-licensing—exchange of technology among companies, Reduces competition on products and in markets
Payment—varies in amount and type of payment: Several factors determine the payment amount. Bargaining used to establish the price. Most licenses granted to companies in which licensee has an ownership stake.
Determinants of Compensation for International Licensing of Technology

2.62.1. 1 - AGREEMENT-SPECIFIC FACTORS
Affecting the Technology Value: Market restrictions (including exports); Exclusivity of the license; Limits on production size; Product quality requirements; Grantback rovisions Tie-in provisions; Duration of the agreement; Age of the technology; Duration of the patent; other constraints on the use of technology

2. 62.1.2 - ENVIRONMENT-SPECIFIC FACTORS
Affecting the Technology Value: Government (of both licensor's and licensee's countries) regulation of licensing; Level of competition among alternative suppliers of similar technology; Political and business risks in the licensee's country
Product and industry norms;Technology-absorbing capacity of the licensee's country

2.62. 2 - Franchising
Specialized form of licensing—franchisor
Sells an independent franchisee the use of intangible property
Operationally assists the business
Franchisor and franchisee—act like a vertically integrated company
Organization of franchising
Franchisor enters foreign market by setting up a master franchise that has the authority to open outlets or develop subfranchises
Franchisor may may enter market by dealing directly with individual franchisees
easier for known franchisors to attract investors

2.62. 2.1 -Operational modifications

- Problems faced by franchisor include securing good locations, finding suppliers, and gaining operating permission from the government
- Difficult to transfer factors that affect success
- The more standardization, the less acceptance in the foreign country
- The more adjustment to the foreign country, the less the franchisor is needed

2.62.2.2 - Management Contracts

Means by which a company may transfer managerial talent

Management personnel assists foreign company

Company gains income with little capital outlay

Host country gets assistance without needing direct investment

2. 62. 3- Turnkey Operations

Company contracts another to build complete, ready-to-operate facilities
- Involve industrial-equipment manufacturers and construction companies
- Customer is often a governmental agency
- Usually involve very large, expensive contracts

Securing contracts entails—public relations, price, export financing, managerial and technological quality, experience, and reputation

2.62. 4 - Joint Ventures

More than one organization owns a company

Consortium—more than two organizations participate Management problems increase with more owners

A partner's control of operations decreases Appeal to companies new at foreign operations

2. 62. 5 Equity Alliances

Collaborative arrangement in which at least one company takes an ownership position in the other(s)

Each party may take an ownership position in the other partners' businesses; Helps solidify collaboration

Problems of Collaborative Arrangements

Many arrangements develop problems that lead partners to renegotiate their relationship

In spite of renegotiated relationships, many agreements break down or are not renewed

Collaboration's importance to partners

One partner may devote more managerial attention to the collaboration; due to differences in size of the partners; Differing objectives—partners' objectives may evolve differently over time.

2.63 - Control problems

Company loses some control over assets shared with others in collaborative arrangement; may lose control of the extent or quality of use of assets

Even though control is ceded to one of the partners, both may be held responsible for problems

Not clear who controls employees in joint ventures

Without control residing with one of the partners, joint operation may lack direction

Partners' contributions and appropriations

Partners' capabilities to contribute may change; weak link may cause drag on the relationship

Suspicions may arise about what other partner(s) is taking from the operation

2. 64- Differences in culture
Companies differ by nationality in how they evaluate the success of their operations differences can mean that one partner is satisfied while the other is not; Some companies prefer not to collaborate with companies of very different cultures; joint ventures from culturally distant countries survive at least as well as those between partners from similar cultures; Differences in corporate cultures may also create problems within joint ventures; compatibility of corporate cultures is important in cementing relationships

2. 65 - Managing Foreign Arrangements
As the arrangement evolves: Partners will have to reassess certain decisions; Environment likely to change; Must reexamine the fit between collaboration and strategy
Dynamics of collaborative arrangements; Companies typically move from external to internal handling of foreign operations; as commitment deepens, cost of switching from one mode of operation to another may be high
Collaboration with local partner provides the company with opportunities to learn about culture and more confidently deepen its commitment to foreign operation
Tensions may develop internally as a company's international operations change and grow

2.66 - Finding compatible partners
Company can: Seek out a partner for foreign operations; Respond to proposals from other companies; Must evaluate compatibility; proven ability to handle similar types of collaboration.

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2. 67 - Contractual provisions & Negotiating process
Some technology transfer considerations are unique to collaborative arrangements; provisions to not divulge technical information; retention of a key component so that partner will not obtain complete information; Secrecy surrounding the financial terms of collaborative arrangements
Guard against consequences of loss of control of assets or intangible property; Contract should spell out: terminating the agreement, methods of testing quality, geographical limitations on the asset's use, management responsibilities of each partner, future commitments of each partner; partner's disposal of outcomes of collaborative arrangement

2. 68 - Performance assessment
When collaborating with another company it is necessary to: Establish mutual goals; Spell out expectations in the contract; Continue to monitor performance; Determine whether to take over the operations

Chapter three: Trade theory and trade policy

3.1 - Introduction

In this chapter we tray to explain the trade theory, the international trade theory, and the important governement role and impact on the international trade, when it made its trade policy and the different effect whether import and export. Trying to explain how the Instruments of Trade Policy can respond to more important questions, which arise as dynamic of trade result. Like

Who will benefit and who will lose from these trades policy instruments? , what are the costs and benefits of protection? , what should a nation's trade policy be? Should the United States or Europe use a tariff or an import quota to protect its automobile industry against competition from Japan and South Korea? Finally the economic groups and their rules and the entire world preferential trade area.

3.2 Trade theory briefly

3.2.1 - **Mercantilism** (1500-1800), Economic philosophy based on the belief that: nation's wealth depends on accumulated treasure (gold), and to increase wealth, government policies should promote exports and discourage imports, also exports bring dollars into a country and imports cause dollar outflow, then this idea is a wrong idea because it is impossible for a country to maintain high exports and no imports:

Inflow of money from exports → domestic prices rise relative to foreign prices → imports rise, exports fall. Then Adam Smith " wealth of nation" 1776 the absolute value theory.David Ricardo 1817 "the Production relative cost".John stewart Male " the international value". Alfred Marshal participation "the exchange demand curve". Professor Haberler "the cost of alternative chance"

3.2. 2 The classical theory: its Target to responde on three question: what is the forme of external trade, goods to import and goods to export to use from the state which is subscribe in the exchange international? , which are the conditions for international exchange? (the equilibrium of members, prices & quantities of goods..), which are the state benefits from its participate on the international trade?, and economicly in general. The 8 supposes on the classical: 1- the neutral of currency. 2- when we look at production factors we notice that: (neutral the time factor,neutral the research and development factor, the common in the production technology). 3- elasticity prices of goods (no monopolies, no diversification of goods) 4- the only variable is the offre, (the resources is fixed to each country, no freedom to transfer the production factors to outisde the country, industry production for consumer goods & no intermediate or investment goods, absent the MNCs effect in the international trade.) 5- in the consumer faction (the consumer prefer is fixed, the fixed in distribution of GNP and in its form on the international trade. 6-The equilibrium in the pay of balance of payments is exist. 7- the complete use of production factors inside each country. 8- no transportation cost effect, or other natural and industrial barriers.

"The percentuals cost theory"Hiksher- Ohlin1919 and Samoel Sun" 1924. Linder " the resemble in the income structure"and after with" Huve power & Linman" Hirch" "Devolope Hiksher-olin theory"Samolson- Lirno" Gray , Sodrichten, Virnon" "the technology superiority & the gap technolgy trade" Posner. Hufbauer. Vernon. Hirsch. Wells Jr. Gruber.Friman."The life cicle production" Vernon. Adam Smith (1723-1790)

You do not make your own clothes or shoes but buy them from your tailor or shoemaker to enjoy the benefits of increased specialization"

Nations should specialize in those goods where they have an absolute advantage, and should import everything else.

3.2.3 - David Ricardo (1772-1823)
Nations can gain from specialization and trade even if they lack an absolute advantage
A nation with comparative advantage sacrifices less resources in production
Each country exports the product for which it has comparative advantage and imports the product for which it has comparative disadvantage. Assumptions
Two countries, two international commodities, fixed endowment of labor in each country, Labor completely mobile within a country, Labor completely immobile between countries, Commodity value determined by labor content, Technology fixed but differs across countries, Production costs constant, independent of quantity produced Full employment of labor, No restrictions on trade, No transportation costs; Terms of Trade = mutually agreed rate of exchange; Number of cheeses per unit of wine, Do both countries have benefit from trade or only one of the countries? , depends on the term of trade: Both benefit if the rate has to be somewhere between the domestic exchange ratios (Between 1-2 cheeses for a unit of wine), Improvement in terms of trade = relative price of exports rises. Deterioration in terms of trade = relative price of exports falls

3.2. 3John Mill's Theory of Reciprocal Demand (How do nations agree on trading price?)
If Nations are in the same size, with similar taste patterns, the gains from trade are shared equally, and if a country has a high demand for a commodity, so it is willing to pay higher price for it.
If nations are in the unequal size, so the domestic price ratio of the larger nation prevails, and small country trades at the relative prices set by the large country completely specializes in good of its comparative advantage attains most gains Larger nation, attains fewer or no gains from trade with a small nation specializes in the good of its comparative advantage but produces the other good too; Transportation Costs: High transport costs make some goods no traded; specialization in the real international economy is not extreme because it is costly to transport goods and services

3. 3Pattern of Trade
Trade is based on comparative advantage and specialization, each country exports the product which it has comparative advantage, and imports the product for which it has not comparative disadvantage. Every country has a comparative advantage in something, even if a nation is absolutely less efficient in producing every good than its trading partners, it is always relatively better in production of some of the goods, Trade is not zero-sum (there are mutual gains to trade),

3.4 - Gains from Trade:
Gains from exchange: domestic consumers substituting the relatively cheaper foreign products for the relatively more expensive domestic products
Gains from specialization*:* gains from shifting domestic resources away from producing products that are relatively cheaper overseas to those products those are relatively more expensive overseas
When relative domestic prices (opportunity costs) of goods are the same at home and abroad, countries do not gain from trade, prices of traded goods equalize across countries.
Three main reasons why specialization in the real international economy is not extreme: Increasing opportunity costs, transportation costs and countries protect industries from foreign competition.

3.5 - Eli Heckscher and Bertil Ohlin (H-O Model) – 1930. Assumptions:
Constant economies of scale. Production technology free available. Endowments of different factors of production (land, labor and capital). Factor proportion as comparative advantage.
Predictions: a country exports product where factors are abundant, e.g. capital-rich countries will export capital-intensive products. Trade benefits sectors which are export-oriented and weakens import-competing sectors. Exports of agricultural products (Aus, Can), exports of textiles and footwear (India, China), exports of automobiles and pharmaceuticals (US, EU, Japan)

Heckscher-Ohlin Factor Endowment Theory: Differences in resources may be the *only* source of comparative advantage and trade. Factors of production (resources) and payments to owners: Capital (machines, technology) which measure by the interest rate. Labor (high skilled, low skilled) which measure by the wages. Land which measure by the rent. Natural resources which measure by the prices. Suppose: 2 countries: Home (C) and Foreign (F). 2 goods (Food and Cloth an example) produced with same technology in both countries. 2 inputs (Labor and Land) of uniform quality across countries. Tastes and preferences same across countries (same indifference curves)Only difference between countries: endowments of Labor and Land resources.

Factor Intensity: Food production is *land-intensive*, if land-labor ratio used in production of food is greater than that used in production of cloth: *Land F* / *Labor F* > *Land C* / *Labor C*
Food production is *land-intensive &* Cloth production is *labor-intensive*
Resource Abundance: Home country is *labor-abundant* compared to foreign country *if* ratio of total amount of labor to total amount of land available in Home is greater than that in Foreign: *Labor*/Land > *Labor**/ *Land** Home is *labor-abundant, land-scarce.* Foreign is *land-abundant* and *labor-scarce*

3.5. 1 Leontief paradox
Leontief found that U.S. exports were less capital-intensive than U.S. imports, even though the U.S is the most capital-abundant country in the world
Factor Prices Equalization:
Before Trade (In Autarky): Home (cheap producers of Cloth) is Labor-abundant and Land-scarce, so…Wages are lower in Home than in Foreign, and Rents are higher in Home than in Foreign.
With trade: Home starts producing more Cloth; less Food ➔ Demand for Labor goes up, wages increase ➔ Demand for Land goes down, rents decrease ➔ Laborers are better off and landowners are worse off ➔ foreign starts producing more Food, less Cloth ➔ Demand for Labor goes down, wages decrease ➔ Demand for Land goes up, rents increase ➔ Laborers are worse off and landowners are better off.
Owners of a country's abundant factors gain from trade, but owners of a country's scarce factors lose, International trade leads to complete equalization in returns to homogeneous factors across countries, Wages, rents and interest rates tend to equalize when countries trade goods and services.

3.6 - International trade is a substitute for international mobility of factors trade*:* Country with abundant skilled labor (EU, Japan, US) imports goods made with unskilled labor (from Mexico, Mediterranean), exports skill-intensive goods.
Demand for unskilled labor in US decreases ➔ wages of unskilled workers in US decrease ➔ converge with Mexican wages of unskilled workers ➔ free migration of labor: Unskilled workers from Mexico move to US where wages are higher ➔ Wages of unskilled workers decrease in US ➔ less free migration of labor.

Here we could answer on some questions, like, has international trade equalized the returns to homogeneous factors in different countries? And Are interest rates, rents, wages and prices of commodities the same all over the world?
No, wages are much higher for doctors, engineers, technicians, mechanics and laborers in the United States and Germany than in Korea and Mexico, more realistically: international trade reduced, rather than completely eliminated, the international difference in the returns to homogeneous factors, Complete factor price equalization is not observed because of… wide differences in resources, differences in technology, imperfect information, barriers to trade, capital flows and immigration, transportation costs, low labor mobility.
Does trade worsen income inequality? A. Forces Causing Greater Inequality of Wages international trade. Lower transport and communication costs, liberalization of trade barriers, production sharing with other countries, immigration, stagnant minimum wage and decline of labor unions skill-biased technological change. B. Forces Causing Greater Equality of Wages. Increase in supply of skilled workers relative to unskilled workers

3. 7 - Other Theories of Trade can not be explained by Hecsher – Ohline theorem: Some trade can not be explained by differences in resources, (mostly trade is between industrialized countries, **Intra-Industry trade and Prices**, wages, interest rates, rents do not equalize completely in the world) also Intra-industry Trade: Intra-industry trade is two-way trade in a similar product, US exports and imports autos to/from Europe and Japan, ¼ of world trade consists of intra-industry trade particularly in manufactured goods among advanced industrial nations, that explained by: 1. Economies of scale: countries to benefit from larger markets. 2. Product differentiation, cars that US is exporting and importing are not exactly the same Pattern of intra-industry trade itself is unpredictable; also Pattern of inter-industry trade is determined by countries' comparative advantage

3. 8 - Linder's Theory of Overlapping Demands: Most trade occurs among similar high-income economies, wealthier country imports more expensive luxury products, luxury products are more likely to be produced in another wealthy country and countries with similar internal demand conditions should trade. Then Wolfgang Stolper and Paul Samuelson – 1941. Likely effects of trade on real incomes of different sets of individuals within an economy, trade benefits owners of production factors with which the economy is well endowed, trade hurts owners of scarce factors, Explains why trade is such a divisive political issue, Simple, elegant predictions for lobbying. Then **Ricardo-Viner** and Empirical observation (e.g. workers and owners in the same industry lobbying jointly), Specificity of production factors (Stolper-Samuelson theorem assumes factors of production to be highly mobile between different industries), Specific factor approach dominant to derive trade policy preferences. Stolper-Samuelson Theorem: Protectionist laws on imports of various grains, Defended by landowning elite (land),Pressure from manufactures (e.g. textile), want to lower tariffs (Richard Cobden) „You must untax people's bread" Urban middle and working classes (labor), External shock (potato crop failure in 1945)

3.9 - Product Life Cycle Theory. Vernon. Explain why a product that begins as a nation's export eventually becomes its import? Stages of the Product Life Cycle: 1) Product innovation occurs in a higher income country, Domestic industry has comparative advantage, Home country exports new product. 2) Foreign companies pick up the new technology and start their own production Once the product is developed, no large research investment is needed by other countries, so technology transfer is simple. 3) Product becomes standardized and is imported into the original home market
Developing countries gain a production advantage. Abundant semi-skilled labor becomes a more important input at this stage in the product life cycle.

3. 10 - The modern products classify:

A- Ricardo products: petrol, natural Gas, industrial rowmaterial, agriculturls...
B- Hikscher-oline products: textile & yarn, steel, cars industry, domesticals products, bicycles...
C- The life cycle product: chimical industry, ingenerials, electronicals, aeroplanes

3.11 – Balance of payment and the three government struments:

The government could use three struments to modify its balance of payments, making a different effect on the international trade.

3.11. 1 The classical government process: IF the target is to Export increase:

Imports increase ➔ deficit in Balance of payments ➔ money output ➔decrease money supply in the state ➔ decrease the general prices level ➔ increase the offre from the strange importer to this country products ➔ increase the export ➔ input new money ➔ equilibrium the balance of payments.

Or if To import increase:

Exports increase ➔ surplus in balance of payments ➔ money input ➔increase the offre of the money in the state ➔ increase the general prices level ➔ decrease the supply from the strange importers on the country products ➔ exports decrease ➔ decrease the money input ➔ output the money for imports ➔ equilibrium the balance of payments

3.11. 2- use the exchange price modification by the central bank: to decrease or increase the money value comparison with the strange money.

3.11.3 - Kinz & the state income using by putting it in the investments or in the savings: Consumption + savings +imports (increase) = consumption + investments + exports (increase)

3.12 - New trade theory: Intellectual history

Pioneers: Paul Krugman, articles in 1979, 1980, 1981, then Jim Brander, thesis in later 1970s, articles in 1982, 84 (with Krugman) & strategic trade policy (with Barbara Spencer) in mid 1980s, and Elhanan Helpman, articles in 1981 and books in 1985 & 1989 (with Krugman). MNCs in 1984, and Jim Markusen, articles in 1980 and on MNCs in 1984.

Krugman model: basic idea

Ricardo, Ricardo-Viner & HO models all focus on differences between nations as a source of trade; Krugman model focuses on geographical concentration of varieties. Trade = made in one nation & purchased in another. Internal IRS explains why prod's concentrated geographically. Resource constraints & IC explain why identical nations would each make some unique varieties. One nation cannot make all (resource constraint).Each firm makes unique variety to avoid direct competition. Each nation makes some unique varieties, but buys some of every variety, so we see IIT between similar (even identical nations).

3. 13 - Monopolistic competition background: Monopolistic competition is when firms compete with each other indirectly since each firm produces a different variety of the good, say cars, electric motors, chemicals, etc. Each firm takes prices of other firms as given and thus views itself as having a monopoly on the "residual demand", i.e. the demand that is leftover after the sales of the other firms are taken account of. As more firms enter the market, 2 things happen: Residual demand curve shifts in for each firm (newcomer's sales reduce demand left for others). Always The Residual demand curves become flatter since the varieties are now closer substitutes (i.e. since there are more 'nearby' varieties, the demand for any single variety is more responsive to price changes of other varieties). Often, i.e. not for all goods. **Trade implications (Krugman model)**
Here we have 2-way trade between 2 identical nations. "Krugman model of trade" (Krugman 1979 JIE, 1980 AER, 1981 JPE). Intra-industry trade only. Home exports manufactured varieties to Foreign and vice versa. Scale & pro-competitive effects

3.14 - Gravity model
Name come law of gravity: gravitational force = M1*M2/distance.
In trade, bilateral trade flow=GDP1*GDP2/distance
GDP exporter proxies for the range of varieties for sell
GDP importer proxies for the demand.
Distance picks up all the cost of trading.
Empirically most successful trade model.
=> Bilateral trade grows at the sum of the GDP growth rates.

3.15 - Synthesis model (Old & New)
Expand the model: we do this mentally rather than in a fully specified model since the concepts are clear from combining the Krugman model with the Std Trade Model. Writing down the full model is complex. Now, we allow relative factor-abundance differences between the nations and add a second sector, which is L-intense to manufactures, which is K-intense. We get a hybrid of the HO model and the Krugman model. This model is often called the Helpman-Krugman model.
Netting out intra-industry trade (i.e. only looking at nation exports of manufactures minus its imports of manufactures), the trade pattern follows the HO Thm, and i.e. L-rich nations export L-intense goods. Plus we have IIT in manufactures. Thus we get both intra-industry and inter-industry trade. As nations' relative endowments become more similar (e.g. US and EU) intra-industry trade is more important than for dissimilar nations (EU and Africa, e.g.).

3.16 - Inter & Intra industry trade
Helpman-Krugman model shows how inter & intra industry trade can co-exist.
If a different factor endowment, net factor content of trade is as in HO Thm, i.e. if we net out IIT, this is the HO model.

3.17 - Trade implications (HK model)
Which countries have more 'IIT' and which have more 'HO trade'?
As nations' relative endowments become more similar, intra-industry trade is more important than for dissimilar nations. (E.g. EU and Africa mostly HO trade). (E.g. US and EU, mostly IIT

What's New? Intra-industry and inter-industry trade explained, we had to ignore this trade by netting it out in the old trade theory. Predicted relative importance of IIT among similar nations is explained. New GFT: 1. Variety effect. More variety than in Autarky. 2. Pro-competitive & scale effects. Lower prices since extra competition forces remaining firms down their AC curves, i.e. better exploitation of IRS. Explains asymmetric political economy of trade liberalisation. North-North liberalisation is easier than North-South, Idea is that North-North means expansion of both manufacturing sectors with much less much inter-sector reallocation of labour, Less or no Stolper-Samuelson effect, Less dislocation for labour and firms

3.18 - Dumping: Dumping is a big issue in WTO law and in trade policy. Dumping is defined as: exporting a good at a price that is below production cost, or exporting a good at a price that is below the domestic price, or exporting a good at a price that is below the price charged in a third market. Plainly, most forms of 'price discrimination' will be considered dumping. All price discrimination is dumping except where domestic price is lowest and all export prices are equal. Price discrimination is a normal business practice; firms engage in it domestically, e.g. airline tickets, concert tickets, bus tickets, volume discounts, etc. In rare cases, dumping may be predatory pricing; original justification for anti-dumping articles in GATT.

3.18. 1 Economics of dumping: Price discrimination requires IC & 'market segmentation', i.e. the goods cannot be brought back into the country to arbitrage the price difference, In Krugman's example, the firm is a monopolist at home but atomistic in foreign market. Firm faces flat demand in foreign market (i.e. amount of sales has no impact on price). Firms are very often more important (e.g. have bigger market shares) in the domestic market than they are in foreign markets. This is called 'market fragmentation' e.g. Europe's car market

3.18.2 External economies and trade
Now consider external economies of scale, basically asserts that an industrial cluster lowers the cost of firms in the cluster. Sources: Specialised suppliers, Labour market pooling, Knowledge spillovers, Real world industries do cluster & often hear LDCs say that there industry faces a chicken-and-the-egg problem: There firms would be competitive if there were enough firms in the sector, e.g. electronics in Taiwan. Used to justify 'Big Push' development strategy.

3.19 - MNC theory
Krugman and the US auto firms producing in Europe, and Opel is owned by US firm GM and sells many cars in Europe. **The 2 questions:** MULTINATIONAL (1) CORPORATION (2)
Why doesn't GM make the cars in the US and ship them to Europe? Trade costs, broadly interpreted, so, there is a reason to make these goods in Europe instead of the US, but why is Opel owned by an American company instead of a European company? These are the 2 key questions in MNC theory: Why are production facilities located in many nations? , this is the 'Multinational' part of MNC. Why are these production facilities owned by a single firm?, this is the 'Corporation' part of MNC.

The 2 questions: answers Why are production facilities located in many nations? This is answered by any of the many trade theories we have; 95% of trade theory is location of production theory, and the transport costs are important considerations in real world, but ignored in our trade theory. Especially when nations have similar c.a. (i.e. the costs of production are not very different, so there is little cost-incentive to concentrate production in one place). Why are these production facilities owned by a single firm? , this is answered by 'theory of the firm'. One of the most common is that the corporation has some firm-specific knowledge that it does not want to license or sell to others, FDI allows the firm to exploit its knowledge without losing control of that knowledge.

3. 20- MNCs, advantages approach & gains from FDI

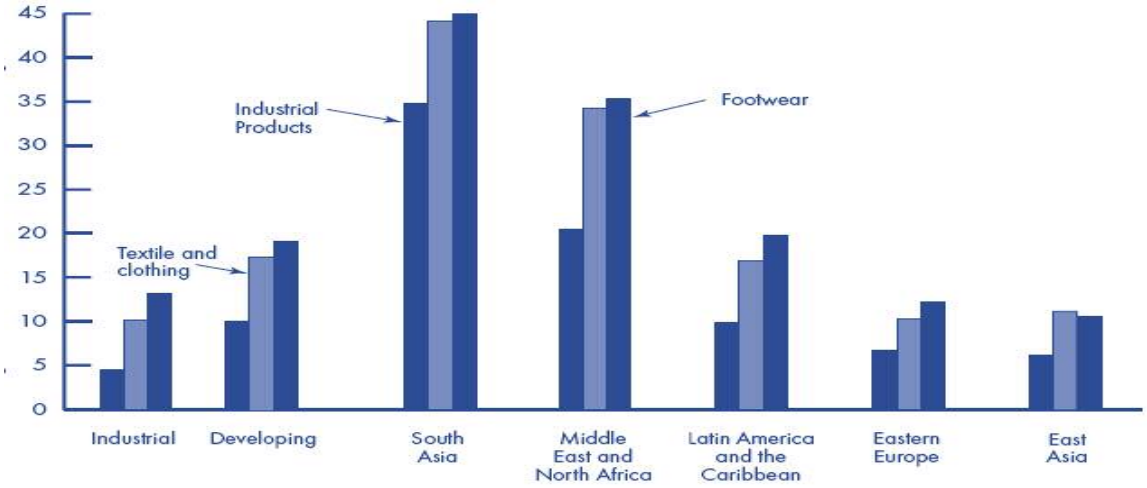
The fact that an MNC finds it advantageous to produce in another nation and to own that facility suggests that the MNC has certain advantages over host-nation firms. Typically firm-specific know-how of some sort, this suggests that MNCs bring with them something positive for host nation, underpins basic belief that MNCs are good, and contrasts with 1970s view that they were bad, nevertheless, host nation government should be aware that MNC and national interests are not always aligned and MNCs are not operating in a perfectly competitive environment. Also the Countries grouped by United Nation: by the Income, education and life expectancy, to three groups of Countries: developed, developing, transition. Developing nations: Very dependent on developed industrial countries as export markets and source of imports. Exports are mostly *primary commodities* (agricultural goods, raw materials, fuels) and *labor-intensive* manufactures Economies hampered by: 1- Structural weaknesses (Infrastructure: lack of roads, schools, hospitals and Low productivity of labor) 2- Corruption. 3- Inadequate institutions (property rights protection, financial markets)

Developing nations: Dependence on primary products (2002 Major export as % of total exports)

Country	product	
Nigeria	Oil	96
Saudi Arabia	Oil	86
Venezuela	Oil	86
Burundi	Coffee	79
Mauritania	Iron ore	56
Zambia	Copper56	
Ethiopia	Coffee	54
Chad	Cotton	40
Rwanda	Coffee	31

The main Problems of Developing Countries: - Economic dualism (high-wage, capital-intensive industrial sector, and low-wage traditional sector). - Modern sector differs from traditional sector in that it has: higher value of output per worker, higher wages, and lower returns to capital, higher capital intensity, and persistent unemployment (especially in urban areas). - Increase in the number of manufacturing jobs leads to a rural-urban migration so large that urban unemployment actually rises. - Dualism is a sign of an economy that is not working well, especially in its labor markets

3. 21 -Problems of Developing Countries: Debt, and the Origin of debt problem, borrowing to finance development 1973-74 and 1979-80 oil shocks,
world recession: fall in commodity prices (exports) → fall in export earnings. Increase in prices of manufactured goods (imports). high interest rates → cost↑ of servicing debt
Dealing with debt, Rescheduling debt: official and commercial bank loans
Structural reforms International Monetary Fund (IMF), structural adjustment programs tight fiscal policies to reduce budget deficits, privatization and market liberalization open trade policy, hardship from IMF programs, World Bank, Makes loans in developing countries to improve infrastructure, alleviate poverty, and assist in restructuring economic policy Debt forgiveness.
Trade barriers limit developing country exports protectionism in industrialized countries especially for agricultural and labor-intensive goods, Tariff protection in agriculture is higher than in manufactures; Tariffs are higher in labor-intensive manufactures than in capital-intensive goods



3.22 -The different function of trade policy.
- Custom restriction to help the inernational trade: (exports support or Imports decrease)
- Non Custom restriction to restriction the international trade: (quota system: import export, private public sector. WTO), and exchange restriction
- Custom duties: to import and to export, on the product value, or on the kind of product, and complex duties (value, kind)
- Custom tariffs:

3.23 - Tariff Types: A tariff is a tax levied on an imported good.
Specific tariffs: Taxes that are levied as a fixed charge for each unit of goods imported
Ad valorem tariffs: Taxes that are levied as a fraction of the value of the imported goods
Compound duty (tariff) is a combination of an ad valorem and specific tariff.
Non-Tariff Barriers: modern governments usually prefer to protect domestic industries through a variety of non-tariff barriers, such as: **Import quotas:** Limit the quantity of imports, **Export restraints, and limit** the quantity of exports.

Classification of Commercial Policy Instruments and their Different effects of Alternative Trade Policies and on the economic.

	Tariff	Export subsidy	Import quota	Volutary export restraint
Producer surplus	Increases	Increases	Increases	Increases
Consumer surplus	Falls	Falls	Falls	Falls
Government revenue	Increases	Falls (government spending rises	No change (rents to license holders)	No change (rents to foreigners)
Overall national welfare	Ambiguous (falls for small country)	Falls	Ambiguous (falls for small country)	Falls

Figure 2 Clasification of Commercial Policy Instruments

3. 24 - International Negotiations and Trade Policy

How was the removal of tariffs politically possible? The postwar liberalization of trade was achieved through **international negotiation**, governments agreed to engage in mutual tariff reduction, The Advantages of Negotiation: It is easier to lower tariffs as part of a mutual agreement than to do so as a unilateral policy because it helps mobilize exporters to support freer trade and it can help governments avoid getting caught in destructive **trade wars**.

An eighth round of negotiations, the Uruguay Round (completed in 1994) resulted in:
Trade liberalization: the average tariff imposed by advanced countries decreased by almost 40%, more important is the move to liberalize trade in two important sectors: agricultural and clothing.
Administrative reforms: creation of the WTO.
How different is the WTO from the GATT? International Trade Agreements:
a Brief History
Internationally coordinated tariff reduction as a trade policy dates back to the 1930s (the Smoot-Hawley Act). The multilateral tariff reductions since World War II have taken place under the General Agreement on Tariffs and Trade (GATT), established in 1947 and located in Geneva; it is now called the World Trade Organization (WTO).
The GATT-WTO system is a legal organization that embodies a set of rules of conduct for international trade policy.
International Trade Theory respond on these questions: why and what do countries trade? Who gains from trade?, why and how do countries restrict trade?
Globalization is the trend for people, firms and governments around the world to become increasingly dependent on and integrated with each other. Trade: goods (cars, computers, textiles, etc), services (banking, tourism, telecommunications, etc), commodities: raw materials, energy; Labor: immigration, outsourcing, Capital Investment: Portfolio investment: government debt, stock, Foreign Direct Investment (FDI) by multinational corporations. Technology and information: Joint ventures, international scientific research and education Political and cultural aspects.

What Drives Globalization? Per capita income converging: convergence of lifestyles and tastes lower transportation costs: increasing travel creates global consumers Advances in communication technology, internet Movement to free trade: reduction of tariff and non-

tariff barriers; creation of trading blocs: EU, NAFTA, etc. Movement to market in state-dominated economies; emergence of countries with high productive capabilities and low labor costs: China, India, Eastern Europe, and Search for higher profits, lower costs of production: economies of scale: large-scale production is cheaper per unit than small-scale

3.25 Trade Liberalization: 'Freeing up' of movement across national borders for trade, investment and finance removal of rules 'restrictions', 'barriers' and 'obstacles' which national governments have traditionally held in place to regulate the activity of foreign firms and to protect their own local economies. Increased specialization between countries: countries specialize in goods they produce relatively cheaper than trading partners. Major factors that determine specialization: climate, resources, (land and raw materials, labor quantity and quality), capital

3.26 - Consequences of Trade: Greater employment opportunities: iindirect employment serving multinational industries can bring many more jobs than the companies themselves; free movement of capital gives the US access to foreign investment: lower interest rates. Higher overall standard of living: variety of products, lower prices, low inflation. Exposure to competition with foreign producers: better quality of products, technological development and innovation with ideas from abroad, higher productivity of domestic workers, higher domestic and world output, higher or lower companies' profits; h*igher* due to economies of scale- cheaper per unit production costs, lower pressure to keep prices low, lower wages for workers.

3. 27 -US Experience

US Trade Policy (Smoot-Hawley Tariff Act of 1930 (log rolling: vote trading between protectionist interests). The Senate made 1253 amendments to the original bill Cordell Hull: 1934 Reciprocal Trade Agreements Act (granting authority to the president for 3 years to negotiate alterations up to 50% of existing import duties) 1974 fast-track procedures, Today Trade Promotion Authority

3. 28 - Controversial impacts of globalization: Outsourcing of production to low cost countries: limits domestic US wage increases, lowers US government tax revenue, Government unable to provide more public goods: leads to job losses, not only in the US.
Mexico: hundreds of thousands of farmers went bankrupt due to competition with US farmers after opening markets under NAFTA provisions in 1994
Africa: cattle farmers forced out of business as a result of cheaply produced (and heavily subsidized) meat from the European Union dumped on African markets.
As countries focus on producing what they make efficiently, inefficient sectors are squeezed out; Job losses in import-competing industries: Ford and GM. Americans lose competitiveness: state of the art factories built overseas and foreign workers become as productive as Americans; unfair competition: rich countries complain they can not compete with low wage economies and poor countries complain they can not compete with subsidies and tariff-protected rich economies; environmental damage. 3/4 of world foreign investment is shared between world's richest nations; within the developing world, stronger economies receive most foreign investment.
Top 10 recipients: China, Brazil, Argentina, Mexico, Republic of Korea, Chile, Singapore, Thailand, Saudi Arabia and Malaysia. 48 least developed countries received next to nothing .

3.29 - Increase in world poverty continues:
Half of world's populations live on < $2/day; poorest nations liberalized their economies the most, and were driven deeper into poverty
Increase in world inequality continues: gap between richest and the poorest 20% of the world's population doubled in the past 40 years, assets of the world's three richest billionaires exceed GNP of all 48 least developed countries and their 600 million people. Rising inequality within countries: in USA 15.8% of population live in poverty; globalization to blame? Poverty in commodity-dependent nations: export earnings of developing countries heavily dependent on a handful of primary commodities, In sub-Saharan Africa: coffee, tea, cocoa, liberalization policies drove farmers to grow these 'cash crops' for export instead of food for local consumption, markets for them flooded and their value plummeted, prices for primary commodities (excluding oil) have fallen by 50% in real terms over the past 20 years; and the results in: falling share of developing countries in world trade, eeconomic decline, makes economy vulnerable to external shocks and financial crisis (Asian Financial Crisis 1990s: as a result of extensive liberalization of the financial sector across the region, foreign capital poured into the newly industrialized countries of East and South-East Asia peaking in 1996, as turmoil hit markets, foreign capital departed quickly, the crisis hit hardest in Indonesia)
Real wages fell by 60% across the country, in Surabaya, Indonesia's largest industrial city, the daily minimum wage collapsed from $2 to $0.30, 40 million people - a fifth of the entire population - fell into poverty, and economy shrank by 13% in 1998. International Monetary Fund: pushes for economic reforms, lends to countries with balance of payments problems. World Bank: advising and lending for development under many conditions. Criticism: loans depend on countries agreeing to 'Structural Adjustment Programs' – cut social spending, lift import and export barriers, cut subsidies, privatize, remove price controls – little evidence that these programs work, but they increase poverty . World Trade Organization: goal, globalization, liberalization of trade, remove barriers to trade, Prime target of anti-globalization protestors

3.30 - Winners and Losers from Trade
International Trade: based on comparative advantage, leads to greater global efficiency
Domestic Consumers: benefit from lower prices and larger quantity/ variety of goods, large number of people each with small gains, collectively large gains to the economy, not an organized force to lobby for free trade. - Domestic Producers (import-competing industries): hurt as firms suffer losses, leave industry, workers lose jobs, small number of firms/people each with significant losses, collectively not a big loss to the economy, ignores dynamic effect on economy as workers move from losing to winning industries – our export firms, organized labor unions, lobby government for protection. As Result bias in political system in favor of protectionism, Attempts by government to shield economy from trade, hurts welfare generally, but may improve welfare of sectors.

3.31 - Methods of restricting trade
Tariffs - tax (duty) levied on products as they move between nations
Quotas – quantity restrictions Subsidies to domestic producers
Regulations – standards, domestic content requirements, etc

3.32 - Arguments for Protectionism:
- Job protection against cheap foreign labor; studies show: trade restraints benefit protected industry; lead to job loses spread across other industries, even if foreign labor is cheap, productivity in the US may be higher
- Infant-industry protection: mature foreign industries drive out of the market young domestic industry
- National security: nation in jeopardy in case of war/boycott if dependent on foreign goods
- Unfair competition: lax environmental, safety standards abroad, government subsidies abroad.
- Retaliation to foreign trade restrictions
- Political bargaining chip (economic sanctions)
- Prevent foreign dumping: dumping – sale at a price below cost of production, ppurpose: drive local firms out of business and establish monopoly
All protectionist arguments assume: there will be no foreign retaliation, government policy makers use information objectively, not influenced by special interests and short-run political expediency.

3.33 - Types of Tariffs:
- Import tariff: levied on imports, Ex: Japanese cars imported into the US
- Export tariff: levied on exported goods as they leave the country, OPEC countries tax oil exports, No export tariffs in the US
- Protective tariff: designed to insulate domestic producers from competition
- Revenue tariff: intended to raise funds for the government budget, no longer important in industrial countries

3.34. 1 How Does an Import Tariff Work? US imposes a tariff on foreign good, 2002-03, steel tariff 8-30%; Price of the foreign good rises by the amount of the tariff.
Domestic protected industry gains jobs: steel industry saved 6,000 jobs
Other domestic industries face higher costs, lower sales and even job losses: auto manufacturers bought more expensive steel, struggled to remain competitive as costs increased, charged higher prices for cars, consumers pay higher prices
Often each job saved costs consumers more than worker's salary, each job saved with a steel tariff cost consumers $800,000.
Tariffs affect poor people more than they affect rich: higher tariffs on products at the lower end of price/quality range, those goods constitute larger share of the low income family budget.
- Specific tariff: fixed monetary fee per unit of the product, example $10 on each imported bicycle with an international price of $100.
- Ad valorem tariff: levied as a percentage of the value of the product (much like a sales tax), example A 20% ad valorem tariff on bicycles generates a $20 payment on each $100 imported bicycle, problem: custom valuation, appraisers determine value, prices fluctuate over time.
- Compound tariff: a combination of the above, often levied on finished goods whose components are also subject to tariff if imported separately

3.35 - Effective Rate of Protection
Effective tariff rate measures the total increase in *domestic production* that the tariff makes possible, compared to free trade, impact of a tariff is often different from its stated amount
➔When tariff rates are low on raw materials and components, but high on finished goods, the effective tariff rate on finished goods is higher than the nominal rate; this is referred to as tariff escalation – tariffs rise with the level of processing in industrialized countries
➔When tariffs are high on raw materials and low on finished goods, the effective rate of protection for finished goods is lower than nominal tariff rate.
Consumer surplus: Measures the amount a consumer gains from a purchase: the difference between the price one actually pays and the price one would have been willing to pay (Lower price – Higher consumer surplus)

Producer surplus: Measures the amount a producer gains from a sale: difference between the price producer receives and the price at which he would have been willing to sell (just above cost of production), Higher price – Higher producer surplus
Social surplus = consumer and producer surplus
Any change in price affects each individual in two ways: as a consumer, as a worker.
3.36 - Welfare effects of Free Trade.
Assume the country is a small economy. The country is a *price taker* - takes the world price as given. It can buy or sell at this price without affecting the price, Domestic price is low, below the world price - Country has comparative advantage, it *exports* (sells) the good. Domestic price is higher than the world price.
- Country does not have a comparative advantages, it *imports* (buys) the good

3. 37 - Terms of trade gain: tariff lowers foreign export prices, Foreigner producers absorb part of the cost of tariff, Costs and Benefits of a Tariff, Tariff may increase welfare for the importing country if the terms of trade gain is greater than the efficiency loss –

3. 38 - Observations from Free Trade Policy
- Quota license holders make a profit from buying imports at low world price and reselling them at a higher price in domestic market: domestic buyers of the good are worse off, domestic sellers of the good are better off, government gets revenue if it sells quota licenses.- Both tariffs and import quotas: raise domestic prices, reduce the welfare of domestic consumers, increase the welfare of domestic producers, and cause deadweight losses, there is an equivalent tariff for any given quota, and vice versa also tariffs are less restrictive than quotas and WTO recommends using tariffs rather than quotas. - Domestic Subsidy: payment and incentives offered by the government to producers in import-competing industries so that they increase production, different forms: cash payments, tax concessions, loans at below market rates and leads to higher domestic production and lower imports.

Export Subsidy: payment and incentives offered by the government to producers intended to raise the volume of exports and protect jobs, an export subsidy paid to a US producer lead to more exports by US producer and lower prices paid by foreigners for US goods

Terms of trade effect: prices of US exports fall, import prices remain the same, terms of trade worsen, terms of trade = P (exports)/P (imports)
-Export-revenue effect: volume of exports increase but revenue may rise or fall; revenue increases if lower prices leads to higher sales, revenue decreases if lower prices do not change sales.

3.40 - Voluntary Export Restraint (VER) an export quota administered by exporting country, imposed at the request of the importer, agreed to by exporter to forestall other trade restrictions, may increase exporting country's revenues as prices charged on foreign goods go up, exactly like an import quota where the licenses are assigned to foreign governments, always more costly to the importing country than a tariff that limits imports by the same amount, tariff-equivalent revenue becomes rents earned by foreigners, produces a loss for the importing country

Local Content Requirements: regulation that requires that some specified fraction of a final good be produced domestically, most often used in automobile industries, can be specified in physical units or in value terms, often has the effect of forcing *lower-priced imports* to include *higher-cost domestic* components or be assembled in a higher-cost domestic market, do not produce either government revenue or quota rents, result in higher prices for consumers. - National procurement: restrict purchase of foreign goods by home government agencies, purchases by the government directed towards domestic goods, even if they are more expensive than imports, health, Safety, or other Standards, some standards reflect not safety concerns but restrictions on imports

3.41 - International Trade Policies Specified by GATT
Low tariffs: countries commit to keeping their tariffs below agreed limits, no discrimination: countries do not discriminate between foreign and domestic goods and services once they have entered the country and tariffs have been paid.
Use tariffs, not quotas: countries use tariffs rather than quotas or other less visible non-tariff barriers if trade must be restricted. -Uruguay Round, 1987-94: GATT changed name to WTO is a full-fledged international organization. GATT applied only to trade in goods, while the WTO included rules on trade in services and on international application of international property rights.

3.42 - World Trade Organization prohibits
Export Subsidies: allowed only for agricultural products
*Import quotas: a*llowed when imports threaten "market disruption"
Tariffs: any new tariff or increase in a tariff must be offset by reductions in other tariffs to compensate the affected exporting countries.

3.43 - Preferential Trading Agreements:
Agreements between two or more nations to lower tariffs with respect to each other but not the rest of the world, WTO, through the principle of non-discrimination ("most favored nation") prohibits such agreements, the formation of preferential trading agreements is allowed if they lead to free trade between the agreeing countries exceptions allow nations to sidestep these rules when they feel threatened, without abandoning the entire process, currently 148 member countries
3. 44 - US Domestic Trade Regulations
US Commerce Department and *US International Trade Commission*
Escape clause : Safeguards (relief to US import-competing firms injured by imports). Trade restrictions can be enacted for 3 years
Countervailing duties: US can impose penalty tariffs on foreign goods in case those are subsidized by foreign governments (unfair competition), ex: In 1996 US Coalition for Fair Lumber Imports filed a countervailing duty petition with US government claiming that US producers were hurt by subsidized lumber exports from Canada. US established a tariff rate quota on Canadian lumber. Lumber imports fell 14%, price of lumber increased 35%.

Lumber-using industries and consumers were hurt – 25 times more workers are employed by lumber-using industries than in lumber producing. Canadians maintained their lumber was cheaper because of productive efficiency, not because of subsidies US Domestic Trade Regulations

3. 45 - Anti-dumping duties
May be imposed if export sales in the US at prices below average costs of production and if foreigners charge in the US less than at home, if Import-competing industries can file anti-dumping request, with evidence of dumping and injury (lost sales, jobs, profits), if have been applied to paper clips, garlic, cell phones, cement, etc, if foreigners pay anti-dumping duty equal to the margin of dumping
Unfair trade practices
Ex: US vs. EU bananas 1993-99, EU restricted imports from US-owned Chiquita and Dole brands from Latin America. WTO ruled US lost $191 million in exports. US applied 100% tariffs on a number of goods from EU

3. 46 - US Trade Regulations
Protection of intellectual property: intellectual property = an invention, idea, product that has been registered and that awards inventor exclusive rights to use invention for a given period of time. Copyrights, trademarks, patents. Pirating occurs when the cost of punishment is lower than the benefits of pirating. Pirating reduces profits of innovating firms and deters them from innovating – leads to fewer products and lower welfare in both nations.
Trade adjustment assistance: help to domestic workers displaced by imports. On average, a displaced worker finds a new job that earns 13% less. Money (wage insurance to cover difference between old and new wages) or retraining assistance

3. 47 - The main Criticism of WTO:
Anti-Globalization (Seattle 1999), WTO and free trade are leading to lower wages in the industrial countries, WTO prohibits environmental regulations. WTO undermines national sovereignty because it can enforce elimination of protectionist policies. WTO encourages third world countries to exploit their workers by paying them low wages. WTO facilitates the spread of low-culture consumer oriented businesses like McDonalds. Anti-sweatshop campaigns. Child Labor opponents

3. 48 - International commodity agreements
Goal: Stabilize commodity prices, reduce price swings. Production and export controls. Changing supply in response to changes in market demand. Buffer stocks (price controls). Multilateral contracts (ex: cartels)

Agreement	Membership	Principal Stabilization Tools
International Cocoa Organization	26 consuming nations 18 producing nations	Buffer stock, export quota
International Tin Agreement	16 consuming nations 4 producing nations	Buffer stock, export controls
International Coffee Organization	24 consuming nations 43 producing nations	Export quota
International Sugar Organization	8 consuming nations 26 producing nations	Buffer stock, export quota
International Wheat Agreement	41 consuming nations 10 producing nations	Multilateral contract

3. 49 - Cartel: OPEC (1960)

Cartels: Attempt to restrict competition among producers, limit supply and charge higher monopoly prices. Face obstacles: Incentive to cheat, cost and demand differences, potential competition with non-members (Russia), substitute goods (alternative fuels)

OPEC Member Country	Value of Petroleum Exports (Million US Dollars)	Percent of Total Exports made up of Petroleum exports
Venezuela	13,737	74%
Nigeria	11,724	97%
Algeria	7,008	63%
Libya	7,763	98%
Saudi Arabia	42,502	85%
Iraq	461	81%
Iran	14,944	81%
Indonesia	6,441	14%
Kuwait	12,217	94%
Qatar	2,987	83%
United Arab Emirates	12,349	51%

3. 50 - Industrial Policy: policies to foster economic growth

Types of industrial policies: government aid to targeted sectors (a*griculture, ship-building, energy, technology, manufacturing (ex: autos), etc, t*ariff protection of declining sectors, export promotion and financing, subsidies to give the advantage to domestic manufacturers over foreign ones, but the criticism is difficult to determine where assistance makes economic sense? Growth Strategies for Developing Countries Industrialization through import substitution: Popular in 1950s and 1960s. Use tariffs or import quotas as temporary measures to get industrialization started. Justification: Infant Industry Protection: key to economic development is creation of a strong manufacturing sector. *Potential* comparative advantage in manufacturing can be realized through an initial period of protection.

3. 51 - Import substitution: pros and cons

PROS: Trade restrictions shelter home industry from competition, giving no incentive for efficiency. Low risk: home market for import-replacing industry already exists. Gives foreign firms an incentive to locate production in developing country, providing jobs CONS: Small size of most developing country markets. No benefits from economies of scale. Results in inefficient scale of production. Protection of import-competing industries draws resources away from all other sectors, including potential exporters. fosters high-cost, inefficient production. Firms become profitable only when protected and tend to resist ever removing those protections; Import Substitution Examples, Not successful: Brazil 1970s-1991: import substitution in computers; India 1950s -70s: after 20 years of economic plans, its per capita income was only a few percent higher than before. Pakistan protected heavy manufacturing sectors for decades, recently started to develop exports of textiles; Successful case: Japan after WWII – Import controls and subsidies, Assistance to targeted sectors

Shipbuilding, steel, autos, machine tools, high-technology, Ministry of International Trade and Industry to target aid to promising sectors, Unclear how much of Japan's success attributed to government assistance
Mixed cases: Communist economies: USSR, China, Eastern Europe, Rapid industrialization and growth 1920-60s, Slow growth in 1970s

3. 52- Export-led growth: pros and cons
PROS: Encourages industries in which developing countries have comparative advantage - such as labor-intensive manufactures. Export markets allow producers to utilize economies of scale. Low level of trade restrictions forces domestic firms to remain competitive
CONS: Depends on the ability and willingness of industrial nations to absorb large quantities of manufactures from developing countries. Vulnerable to recessions and protectionist reactions abroad.
Example of export-led growth: East Asian newly industrialized countries: Spectacular growth of more than 10% per year. Hong Kong, Taiwan, South Korea, and Singapore (1960s). Malaysia, Thailand, Indonesia, and China (late 1970s - 80s). less protectionist than other less developing countries, but not policy of complete free trade. Other Factors in Growth: high saving rates. Rapid improvement in public education. Government support for research and development.
3. 53 - China since 1980s: Transformation from extreme import-substitution to exports. Rapid 10% annual growth. Despite heavy control of economy by Communist government. most foreign investments are into long-term projects- stability. Major demographic and macroeconomic problems (massive migration from rural to urban areas, needs 12-15 m new jobs each year, easy credit & insolvent banking plus fixed exchange rate have led to an overheating economy)
Major structural economic problems: (State-owned enterprises receive majority of credit but most essentially bankrupt - if there actually was bankruptcy. Rule of man, not rule of law, so concern about corruption, property rights, patronage, bureaucracy, etc. Problems with intellectual property, technology licensing)
Why not encourage both import substitution and exports? A tariff that reduces imports also necessarily reduces exports. In many cases, import-substituting industrialization policies dovetailed naturally with existing political biases

3.54 - Trade Blocs: a Step toward Multilateral Free Trade? Free trade in the world can be reached by two different paths: multilateral negotiations (through WTO). Regional integration, then negotiations among regional groups, Cornerstone of WTO: if a country cuts tariffs for one trade partner, it should cut them for all other countries

3. 55 - The Main Criticism of WTO:
Slow in negotiations, long debates between 148 countries
Non-tariff barriers (countervailing duties) can be imposed by individual countries after general tariffs are lowered. Free riders (Japan) – members who import little and export a lot benefit from openness of other countries. Regional agreements between a few countries may be easier to negotiate (ex: NAFTA, 75% of Canada's trade is with US)

3. 56 - Reasons for regional trade agreements
Promotes economic growth: Access to larger markets, economies of scale. Encourages specialization. Attracts foreign investment. Non-economic goals: help manage immigration flows. Enhance regional security. Solidifies domestic economic reforms: East European nations have looked to association with the EU as a way of locking in economic reforms

Preferential trade area: Member countries agree to lower trade barriers within the group to levels below those erected against outside economies.

Levels of Regional Economic Integration

Free trade area (ex: NAFTA): eliminates all trade restrictions between members of the trade bloc each member maintains its own restrictions on trade with third countries

Customs union: (Ex: Benelux) members agree on common tariffs against nonmember countries

Common market: (Europe before it became EU, goal of MERCOSUR) free trade of goods among members, common tariffs against outside countries, free movement of factors of production (labor, capital) among members.

Economic union (European Union) has all the characteristics of a common market uniform set of macroeconomic and microeconomic policies

3,57 Active Regional Trade Blocs:

3.57 .1 - **Southern Cone Common Market (Mercosur)**

Argentina, Brazil, Paraguay, Uruguay, Chile , Bolivia.

Originated in 1988 as a free trade pact between Brazil and Argentina. The pact expanded in March 1990 to include Paraguay and Uruguay. These countries have: A combined population of 200 million. An average annual growth rate of 3.5% for GDP. MERCOSUR countries have significant trade diversion issues. Combined GDP >$1 trillion. Customs Union (No tariffs between members. Common external tariff. Agreement on capital – no restriction on capital flows, protection against expropriation. Intellectual property protections)

3. 57. 2-The Association of Southeast Asian Nations (ASEAN): *Free trade area.*

Created in 1967, Objective to achieve free trade between member countries and achieves cooperation in their industrial

Brunei, Indonesia, Laos, Malaysia, the Philippines, Myanmar, Singapore, Thailand, and Vietnam

Progress limited by Asian financial crisis of the 90's

3.57.3- Central American Common Market (CACM):

Common market, established in 1965, it is now being revived after years of civil war in several member countries. Costa Rica. Nicaragua. Honduras. El Salvador. Guatemala. Panama

3.57. 4 -The Caribbean Community (CARICOM):

Antigua and Barbuda. Montserrat. St. Vincent & Grenadines. Surinam. Trinidad & Tobago. Dominica. St. Kitts & Nevis. Bahamas. Grenada. Barbados. St. Lucia. Guyana. Belize. Jamaica

1973: English-speaking Caribbean countries. Moving toward a full common market, but behind schedule, Failed for third time to establish common external tariff. Free Trade Area of the Americas. Talks scheduled for January 2005 did not occur

Two stumbling blocks include intellectual property rights and reductions in agriculture subsidies

3.57. 5 - APEC Asia-Pacific Economic Cooperation
21 Members: Australia; Brunei; Canada; Chile; China; Hong Kong; Indonesia; Japan; South Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; Philippines; Russia; Singapore; Taiwan; Thailand; United States; Vietnam
Pledged to liberalize trade among themselves by 2015. Recently China began signing bilateral free trade deals with a number of APEC members
Founded in 1990 to 'promote open trade and practical economic cooperation'
'Promote a sense of community' 50% of world's GNP, 40% of global trade
Despite slow progress, if successful, could become the world's largest free trade area. Many of these groups have been dormant for years. Significant political turmoil in several African nations has persistently impeded any meaningful progress. Also, deep suspicion of free trade exists in several African countries. The argument most frequently heard is that because these countries have less developed and less diversified economies, they need to be "protected" by tariff barriers from unfair foreign competition. Given the prevalence of this argument, it has been hard to establish free trade areas or customs unions.

3. 57. 6 CAIRNS GROUP G20
Members: Argentina; Australia; Bolivia; Brazil; Canada; Chile; Colombia; Costa Rica; Guatemala; Indonesia; Malaysia; New Zealand; Paraguay; Philippines; South Africa; Thailand; Uruguay
Group of agricultural exporting nations formed in 1986. Want to free up trade in agricultural products, ensure that their products are not excluded from markets in Europe and Asia. The developing country members of this group have now formed their own grouping, led by rapidly growing countries and major exporters -Brazil, China, India, and South Africa. Insist that rich countries make concessions on agriculture before there will be any final agreement on services or reductions in tariffs on manufactured goods

3.57. 7 -North American Free Trade Area, 1994 NAFTA: NAFTA agreement:
2,000 pages (22 chapters). Transition to free but not completely free trade. Progressive elimination of all tariffs within 5 years. Agricultural tariffs are to be eliminated entirely by 2009. Harmonization of policies on fair competition, trade in services, government procurement, and intellectual property rights, does not cover immigration. Mexican oil industry to remain under state ownership. Establishes strict local-content requirements. to prevent non-NAFTA countries from setting up assembly-only operations in Mexico to gain duty-free access to US and Canada

3.57. 7. 1 - NAFTA's Expected Benefits
Mexico: Stood to gain the most from access to large industrial markets and new inflow of investment from US and Canada
Canada: Trades with US and very little with Mexico, gain from access to large US markets
United States: Gains from access to Mexican market, gains from cheap labor and parts access to oil, less immigration pressure, access to Canadian natural resources

3.57.7. 2 - NAFTA's Positive Impact so far
Trilateral trade increased significantly: most of the increase in trade between US- Mexico and US-Canada resulted from trade creation
lower tariffs result in more trade: Canada-Mexico trade increases came mostly from trade diversion more imports from Mexico, fewer from China, Closer political ties were built among the three nations (especially between the US and Mexico), and they refrained from building new trade barriers even during recession

3.57.7.3 -Negative Impacts of NAFTA on the United States
Before NAFTA US had trade surplus with Mexico: US exports to Mexico > imports from Mexico
After NAFTA US has trade deficit with Mexico: imports from Mexico > exports
Eliminated hundreds of thousands of manufacturing jobs in US, Pressure to reduce wages of lower-skilled workers relative to other workers in the U.S.
U.S. tends to import goods produced by lower-skilled workers
U.S. workers feel more insecure about their economic future as both wages and union activity are increasingly constrained by threats from employers to move overseas

3.57.7.4 Negative Impacts of NAFTA for Mexico
Half of US foreign direct investment into Mexico was into U.S.-owned ***maquiladoras*** (assembly plants located on the US-Mexico border), Mexican input of components in the maquiladora industry is less than 3%, and the rest are imported goods. Limits development of secondary industries in Mexico that would create more jobs and reduce the number of imports needed Growth of per capita income slowed to 1% from 3.2% during 1948-73. 1.5 million Mexican *campesino* farmers displaced due to imports of subsidized U.S. corn. In 1994 -2003 9.3 million people entered labor force, while only 3 million jobs were created, People forced to look for jobs in the U.S.
Migration to the U.S. more than doubled since 1994, Migrant deaths at U.S.-Mexico border increased by a 500% since 1994 (3,000 lost lives)
3. 57. 7. 5 - The Case For and Against NAFTA: Pros: Enlarged and productive regional base. Labor-intensive industries move to Mexico. Mexico gets investment and employment. Increased Mexican income to buy US/Canada goods. Demand for goods increases jobs. Consumers get lower prices
Cons: Loss of jobs to Mexico. Mexican firms have to compete against efficient US/Canada firms
Mexican firms become more efficient. Environmental degradation. Loss of national sovereignty
3.57. 7. 6 - NAFTA Results: Recent surveys indicate that NAFTA's overall impact has been small but positive
From 1993 to 2006, trade between NAFTA's partners grew by 250 percent, Canada's trade with NAFTA partners increased from 70% to more than 80% of all Canadian foreign trade Mexico's trade with NAFTA partners increased from 66% to 80% of all Mexican foreign trade.All countries experienced strong productivity growth
The United States has lost 110,000 jobs per year due to NAFTA
Many economists dispute this figure because more than 2 million jobs a year were created in the US during the same time period The most significant impact of NAFTA has not been economic, but political NAFTA helped create the background for increased political stability in Mexico

3.57. 8 - The Andean Community
Bolivia, Chile, Ecuador, Colombia, and Peru signed an agreement in 1969 to create the Andean Pact; The Andean Pact was largely based on the EU model, but was far less successful at achieving its stated goals. By the mid-1980s, the Andean Pact had all but collapsed and had failed to achieve any of its stated objectives. Nearly failed. Rejuvenated in 1990 in the Galapagos Declaration; Five current members include Bolivia, Ecuador, Peru, Colombia, and Venezuela. Objectives included the establishment of a free trade area by 1992, a customs union by 1994, and common market by 1995. Operates as a customs union currently

3.57.9 - Central American Common Market
1960s: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua.
Collapsed in 1969

3. 57. 10 - European Union: 27 countries, nearly 500 million people
European Union Goals: Started as a common market in coal and steel in 1951 "Insurance policy" for peaceful future, Abolition of tariffs, quotas and other trade restrictions. Common external tariff for non-EU member countries. Free movement of capital, labor and businesses. Common policies on transport, agriculture, and competition.

3.57. 10. 1 How does the Union work? Council of the European Union (represents member states)
One minister from each country, Votes weighted according to population size
On important questions (amending treaties, launching new common policy or allowing a new country to join EU), the Council has to agree unanimously, Each EU country presides over the Council for a 6-month period
European Commission (politically independent body, upholds collective European interest) 25 members – one per country
European Parliament (represents citizens) 732 members, Each country has certain number of votes depending on population size

3.57. 10. 2 European Union Enlargement
At 2004: Poland, Czech Rep, Hungary, Slovakia, Slovenia, Lithuania, Cyprus, Latvia, Estonia, Malta, Romania and Bulgaria 2007
Albania, Bosnia, Croatia, Macedonia, and Serbia and Montenegro—promised they can join EU once they are ready
Majority were socialist until 1989. All have much smaller economies and much lower per capita GDP's than existing EU members (except Greece). Majority increased trade with EU greatly in past 5 years. Increase in foreign direct investment capital flows from EU to these countries in anticipation of accession, Candidate members had to demonstrate: Stability of institutions, and guaranteed democracy, rule of law, human rights and protection of minorities. Functioning market economy which is ready to compete in the EU market and Adherence to the EU's aims of political, economic and monetary union
Attractive for investors
Slovakia and Poland, Low 19% flat tax for corporate and personal income, Good basic education, High labor productivity, Low wages (20% of those in Austria), Closer than China, Slovakia becoming a car manufacturing center of Europe, Volkswagen, Hyundai and Peugeot

3.57. 10. 3 - EU achievements
More trade within EU, EU countries agreed to recognize equivalence of certification systems, professional qualifications, educational diplomas (improves mobility of workers), job qualifications (improves mobility of workers), National tax systems became more similar, Steps have been taken to harmonize national laws on safety and pollution, on business, on intellectual and industrial property rights and Free movement of persons.
Current problems of EU-25
High unemployment benefits. Future problems with state pension schemes as population ages. High budget deficits relative to Stability Pact level of 3% of GDP. Hungary budget deficit 6% of GDP in 2005. Poland expecting 6% in 2006. Common Agricultural Policies. EU subsidizes its exports, dairy products and sugar at €2.8 billion ($3.4 billion) a year.

Tax harmonization: Poland and Slovakia, corporate-tax rate is 19%, in Germany 38%. Estonia levies no tax on reinvested profits. Low corporate taxes attract foreign investment away from "old" EU members. Other taxes are higher in "new" member's enlargement

3.57 10 4 - European Monetary Union (EMU)
In December 1991, EC members signed a treaty (the Maastricht Treaty) that committed them to adopting a common currency by January 1, 1999.14 the euro is now used by 12 of the 25 member states of the European Union; these 12 states are members of what is often referred to as the euro zone. The 10 countries that joined the EU on May 1, 2004, will adopt the euro when they fulfill certain economic criteria—a high degree of price stability, a sound fiscal situation, stable exchange rates, and converged long-term interest rates. The current members had to meet the same criteria. Three long-term EU members, Great Britain, Denmark, and Sweden, are still sitting on the sidelines. The 12 countries agreeing to the euro locked their exchange rates against each other January 1, 1999. Euro notes and coins were not actually issued until January 1, 2002. In the interim, national currencies circulated in each of the 12 countries. However, in each participating state, the national currency stood for a defined amount of euros. After January 1, 2002, euro notes and coins were issued and the national currencies were taken out of circulation. By mid-2002, all prices and routine economic transactions within the euro zone were in euros.

1991 Maastricht Treaty – plan of transition to the EMU
Prospective members join the common Exchange Rate Mechanism: in practice, currencies pegged to the DM, Germany has low inflation, independent central bank, and reputation for tough anti-inflation policies, countries imported Bundesbank's credibility as inflation fighter, exchange rates could fluctuate up or down by as much as 2.25% relative to an assigned par value, European currencies float against $, yen, etc.
Exchange rate margins to be narrowed, eventually fixed: during the currency crisis in 1992, Britain and Italy allowed their currencies to float, in 1993 most EMS currency bands were widened to ± 15% in face of continuing speculative attacks.
National currencies replaced by a single currency: members of the Euro Zone as of January 1, 2001, Austria. Belgium. Finland. France. Germany. Greece. Ireland. Italy. Luxembourg. Netherlands. Portugal. Spain. (Sweden. United Kingdom. Denmark. Not in Euro zone)
Macroeconomic convergence criteria for admission to EMU - Maastricht criteria
Inflation: maximum rate 1.5% above the average of three EU member states with lowest inflation.; Exchange rate stability: no devaluing
Budget deficit: maximum 3% of GDP
Public debt: maximum 60% of GDP

Monetary and Fiscal Policies
Monetary Policy (money supply, interest rate, exchange rates) Based on U.S. Fed Reserve model, European Central Bank in Frankfurt , 12 Euro area national central banks, currently worries about high inflation, strong €, slow economic growth
Fiscal Policy (government expenditures and taxation), responsibility of national governments, Maastricht criteria puts constraints on expenditures (Budget deficit < 3% of GDP and borrowing <60% GDP, limited ability to cushion country shocks)
How desirable is EMU: Benefits: Lower transaction costs: no money conversion, price comparison. Exchange rate risk eliminated. Increased economic integration, competition and efficiency. Lower inflation and interest rates. Costs: Radical change is costly for people / firms. Political arguments. Loss of monetary policy and exchange rates as economic adjustment tools for individual countries. Adjustment to shocks depends on

fiscal policy, wage flexibility and labor mobility. If one country is in recession, runs deficit and borrows money, interest rates increase for the entire Euro zone. Last two are low in Europe; New Regionalism, Changed context, End of the Cold War. Global interdependence and neo-liberal ideas in OECD countries (and GEMs), Signaling openness, market access. Frustration with WTO/GATT. Band wagoning and balancing, Change of US, Japanese and EU attitudes

3. 58 - Regionalism and the WTO
RTAs are the most important exception that the WTO permits against the principle of non-discrimination. Trade within discriminatory regional agreements in 2000: 43% of total world trade (more than 50% today). Art XXIV GATT. Art V GATS. Committee on RTAs
Three conditions:
1) Coverage: GATT (substantially all trade), GATS (substantial sectoral coverage)
2) Duties and regulations not higher then ex ante
3) Transparency
Duties and other restrictive regulations of commerce are removed on substantially all intraregional trade within reasonable period of time. Duties and other regulations of commerce are not higher or more restrictive after the formation of the CU/FTA than before the formation of the CU/FTA is notified to the WTO, surveillance and monitoring
Enabling Clause
While the move toward regional economic integration is generally seen as a good thing, some observers worry that it will lead to a world in which regional trade blocs compete against each other. In this possible future scenario, free trade will exist within each bloc, but each bloc will protect its market from outside competition with high tariffs. The specter of the EU and NAFTA turning into economic fortresses that shut out foreign producers with high tariff barriers is worrisome to those who believe in unrestricted free trade. If such a situation were to materialize, the resulting decline in trade between blocs could more than offset the gains from free trade within blocs.

3. 59 - Regional Economic Integration: One notable trend in the global economy in recent years has been the accelerated movement toward regional economic integration, Regional economic integration refers to agreements among countries in a geographic region to reduce, and ultimately remove, tariff and non-tariff barriers to the free flow of goods, services, and factors of production between each other
The Economic Case for Integration: Stimulates economic growth in countries. Increases FDI and world production, Countries specialize in those goods and services efficiently produced, Additional gains from free trade beyond the international agreements such as GATT and WTO

3. 60 - The Political Case for Integration: Economic interdependence creates incentives for political cooperation; this reduces potential for violent confrontation, together, the countries have more economic clout to enhance trade with other countries or trading blocs
Political Motivations (Drivers) : Political goals: Improvement of inter-state relations/security concerns within a region (e.g. EC, ASEAN (communist threat)). The New Security Agenda (e.g. NAFTA). Regionalism as a bargaining tool (with trading partners and TNCs). Import-substitution policies and leverage to negotiate with TNCs (Andean Pact) (Raoul Prebisch). Supply and demand for (Regional aid project, e.g. EPAs). Leverage for negotiations (CARICOM), pressuring the EU (APEC). Constant struggle for having a strong BATNA (EU-US); Regionalism as a mechanism to lock-in reforms (and time-inconsistency problem)

Mexico and NAFTA. EU enlargement. Signaling to investors. Regionalism to satisfy domestic political constituencies. Regionalism as an elitist idea (exporting the EU model). Ease of negotiating and implementing agreements. Increasing number of actors increase transaction costs (negotiations and compliance). Asymmetry of power. Bureaucratic capacities

3. 61 - Economic Motivations : Regionalism over Multilateralism, Protection of sectors that would not survive in global competition (yet might hinder further multilateral integration), Opportunities for deeper integration
Regionalism over unilateralism and status quo: Larger markets (economies of scale, training camp); Increased FDI (regional hubs)

3. 62- New Regionalism
Changed context: End of the Cold War. Global interdependence and neo-liberal ideas in OECD countries (and GEMs). Signaling openness, market access. Frustration with WTO/GATT. Bandwagoning and Balancing. Change of US, Japanese and EU attitudes. Regionalism and the WTO. RTAs are the most important exception that the WTO permits against the principle of non-discrimination. Trade within discriminatory regional agreements in 2000: 43% of total world trade (more than 50% today). Art XXIV GATT. Art V GATS. Committee on RTAs

3.63- Impediments to Integration
Integration is hard to achieve and sustain: Nation may benefit but groups within countries may be hurt .Potential loss of sovereignty and control over domestic issues
The Case against Regional Integration; Economists point out that the benefits of regional integration are determined by the extent of trade creation, as opposed to trade diversion. Trade creation occurs when high cost domestic producers are replaced by low cost producers within the free trade area; trade diversion occurs when lower cost external suppliers are replaced by higher cost suppliers within the free trade area.

3. 64 - Evolution of the European Union
Product of two political factors:
Devastation of WWI and WWII and desire for peace
Desire for European nations to hold their own, politically and economically, on the world **stage:**
1951 - European Coal and Steel Community ➔ 1957- Treaty of Rome establishes the European Community ➔ 1994 - Treaty of Maastricht changes name to the European Union➔ Political Structure of the European Union ➔European council ➔Heads of state and commission ➔President resolves policy issues and sets policy direction
European Commission ➔ 20 Commissioners appointed by members for 4 year terms
Proposing, implementing, and monitoring legislation ➔ European parliament
630 directly elected members ➔ Propose amendments to legislation, veto power over budget and single-market legislation, appoint commissioners ➔ Court of justice
Council of ministers

3. 65 - The Single European Act
This act committed member countries to work toward the establishment of a single market by December 31, 1992. The act was born out of:
Frustration among members of the European Community regarding the barriers to the free flow of trade and investment between member countries

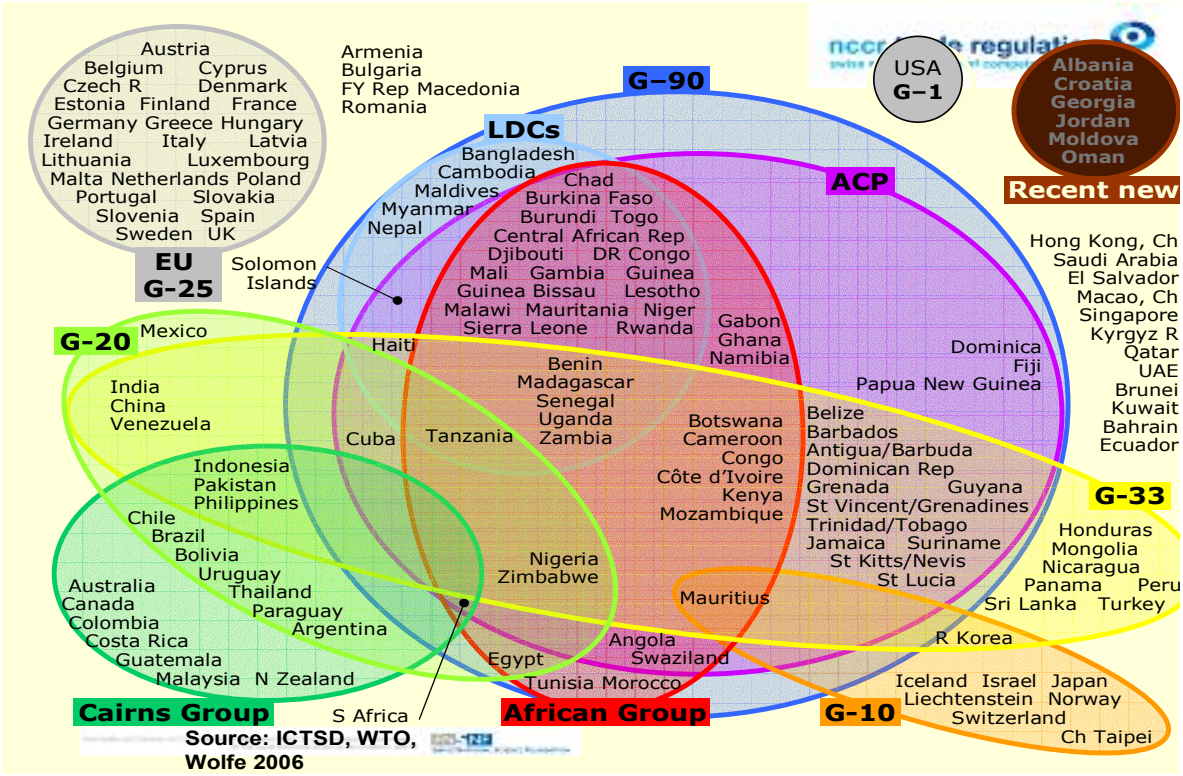
A need to harmonize the wide range of technical and legal standards for doing business The Delors Commission proposed that all impediments to the formation of a single market be eliminated; The act was independently ratified by the parliaments of each member country and became law in 1987; objectives: Remove frontier controls. "Mutual recognition" of product standards. Open public procurement to non nationals. Lift barriers to banking and insurance competition. Remove restrictions on foreign exchange transactions. Abolish Cabotage restrictions

3.66 - Conclusion

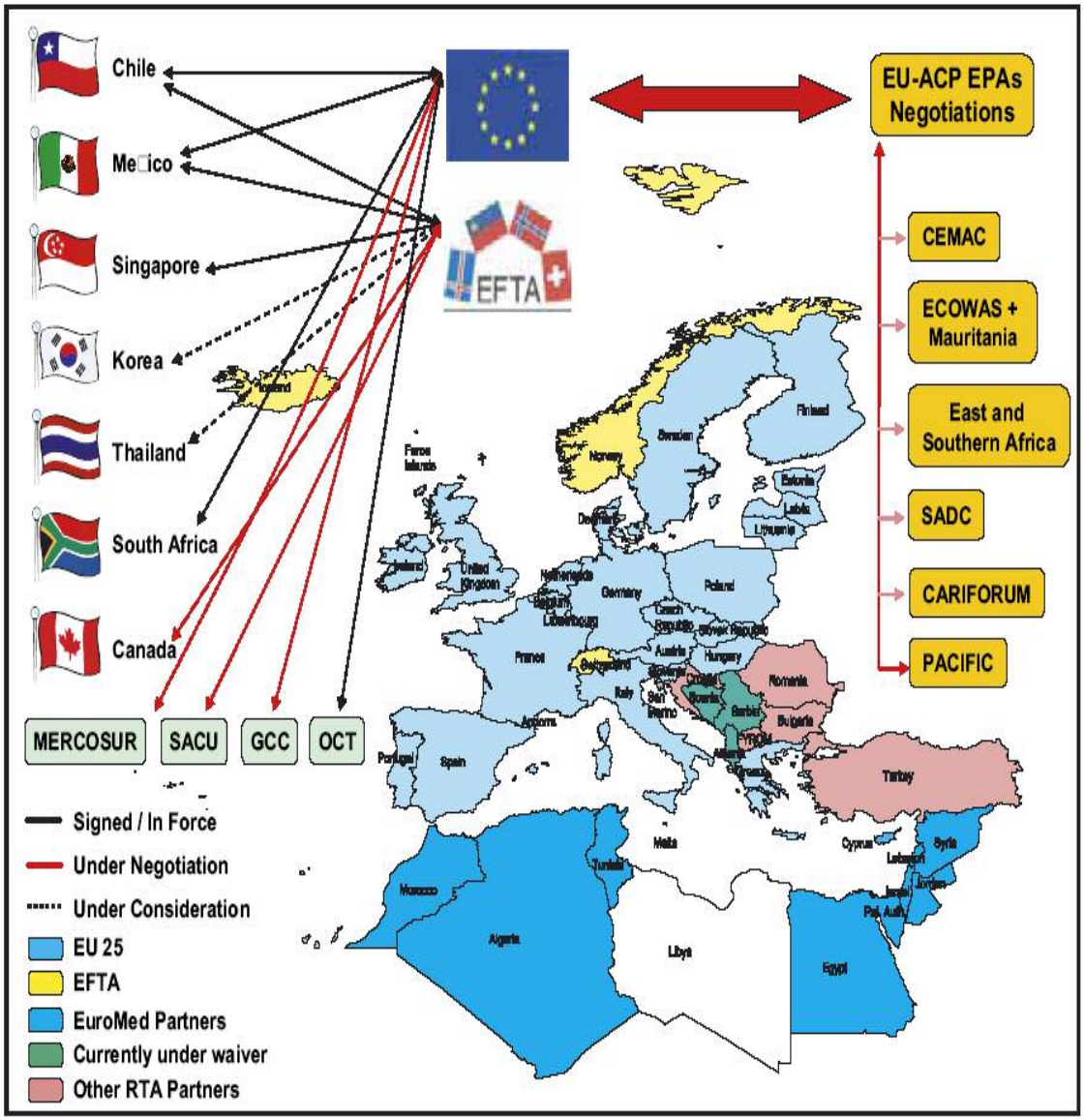
International trade is a substitute for international mobility of factors, and vice versa, Labor mobility (migration) can substitute for trade in labor-intensive goods, International capital flows (investment) can substitute for trade in capital-intensive goods, No theory thoroughly explains all trade, predicts it all accurately, and establishes limits on where trade does or does not occur. Every theory has advantages, and it may be better to consider theory in combination rather in independently. Also the Trade Creation vs. trade Diversion: Ambiguous Welfare Effects of a Trade Bloc, The formation of a trade bloc has ambiguous welfare effects in a world with trade restrictions

Free trade area creates additional trade: Lower trade restrictions leads to higher trade among countries who are members of the bloc Free trade area is also likely to divert trade, Members of the bloc often start buying goods from other members rather than from the world's true lowest-cost suppliers, Example of trade diversion in Mercosur: trade shifted into Mercosur and away from rest of world Positive welfare effect of a free trade area if gain from trade creation exceeds losses from trade diversion.

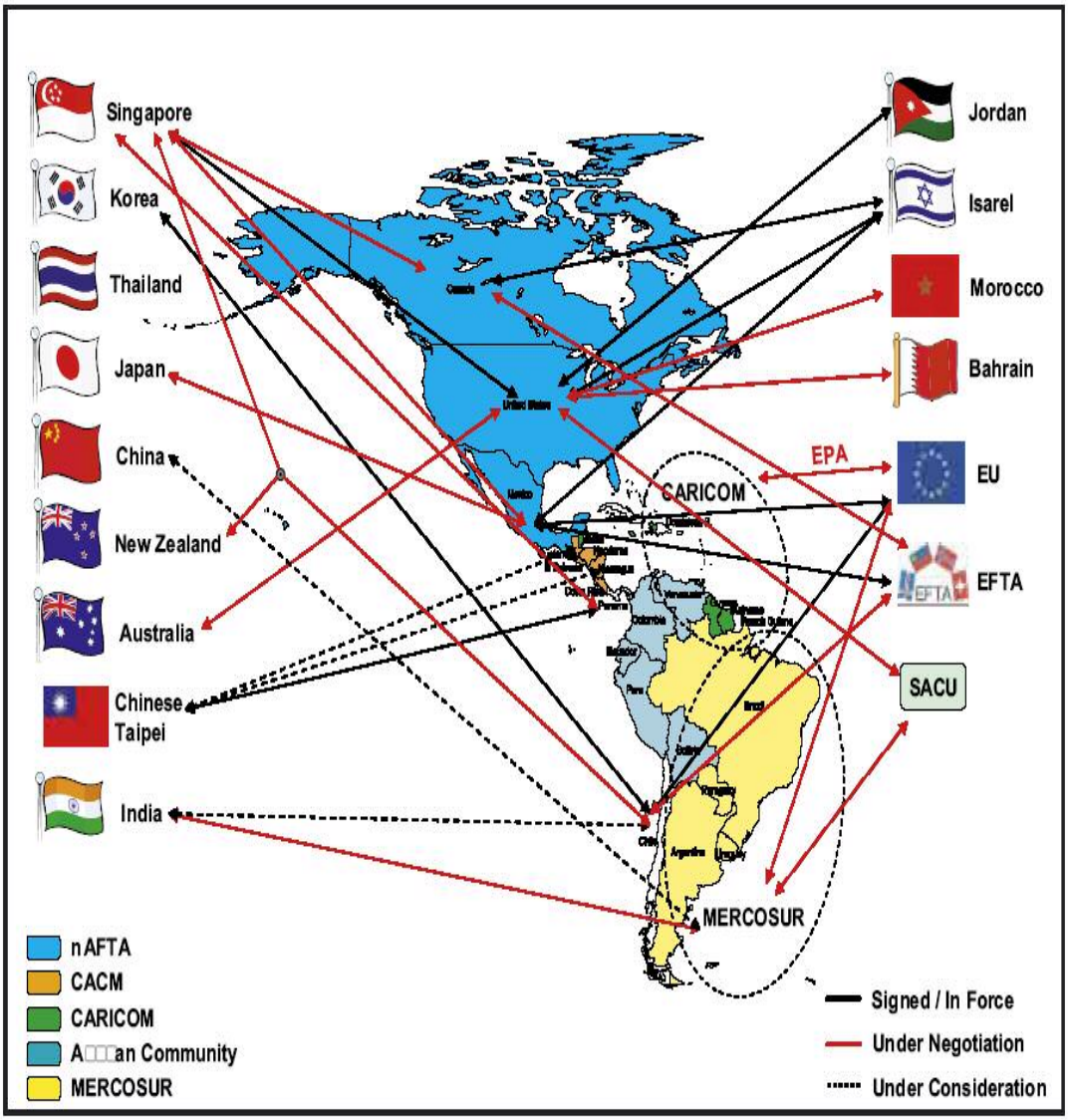
The world economic countries group



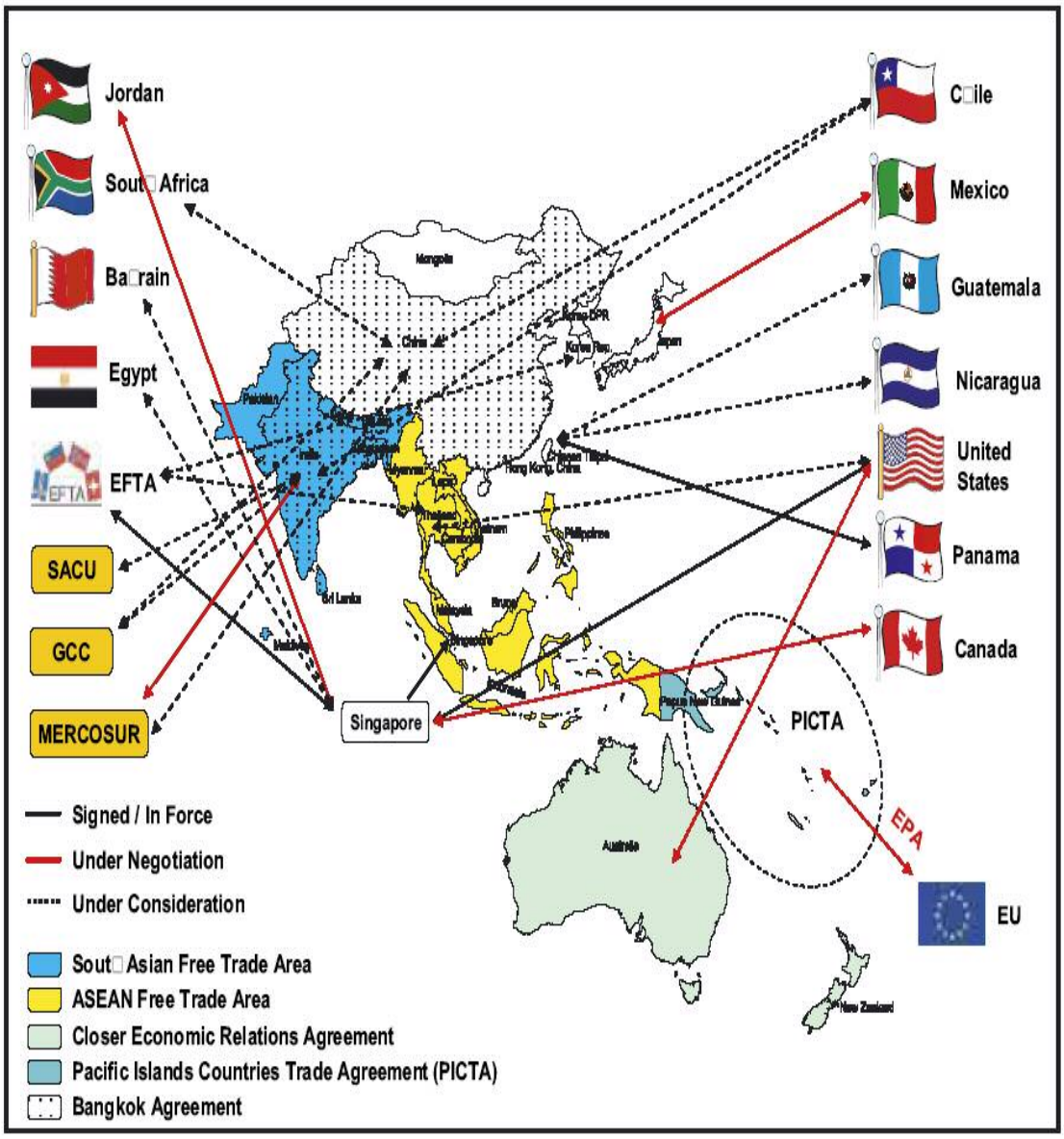
Map 1: European RTA Network



Map 2: Western Hemisphere RTA Network



Map 3: Asia-Pacific RTA Network



Map 4: Africa RTA Network

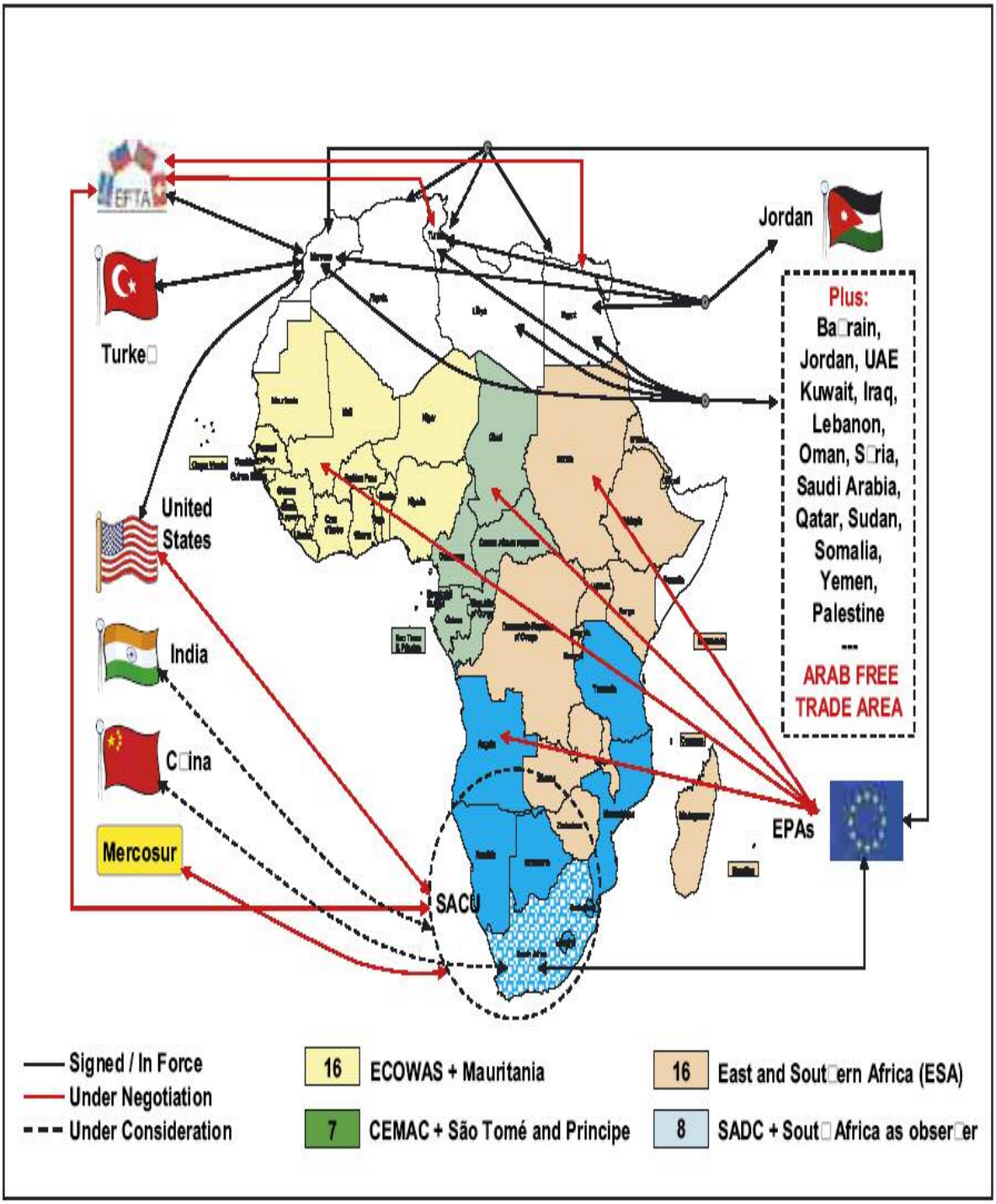


Figure 2.

Map III: Cross-Regional RTAs as of February 2005

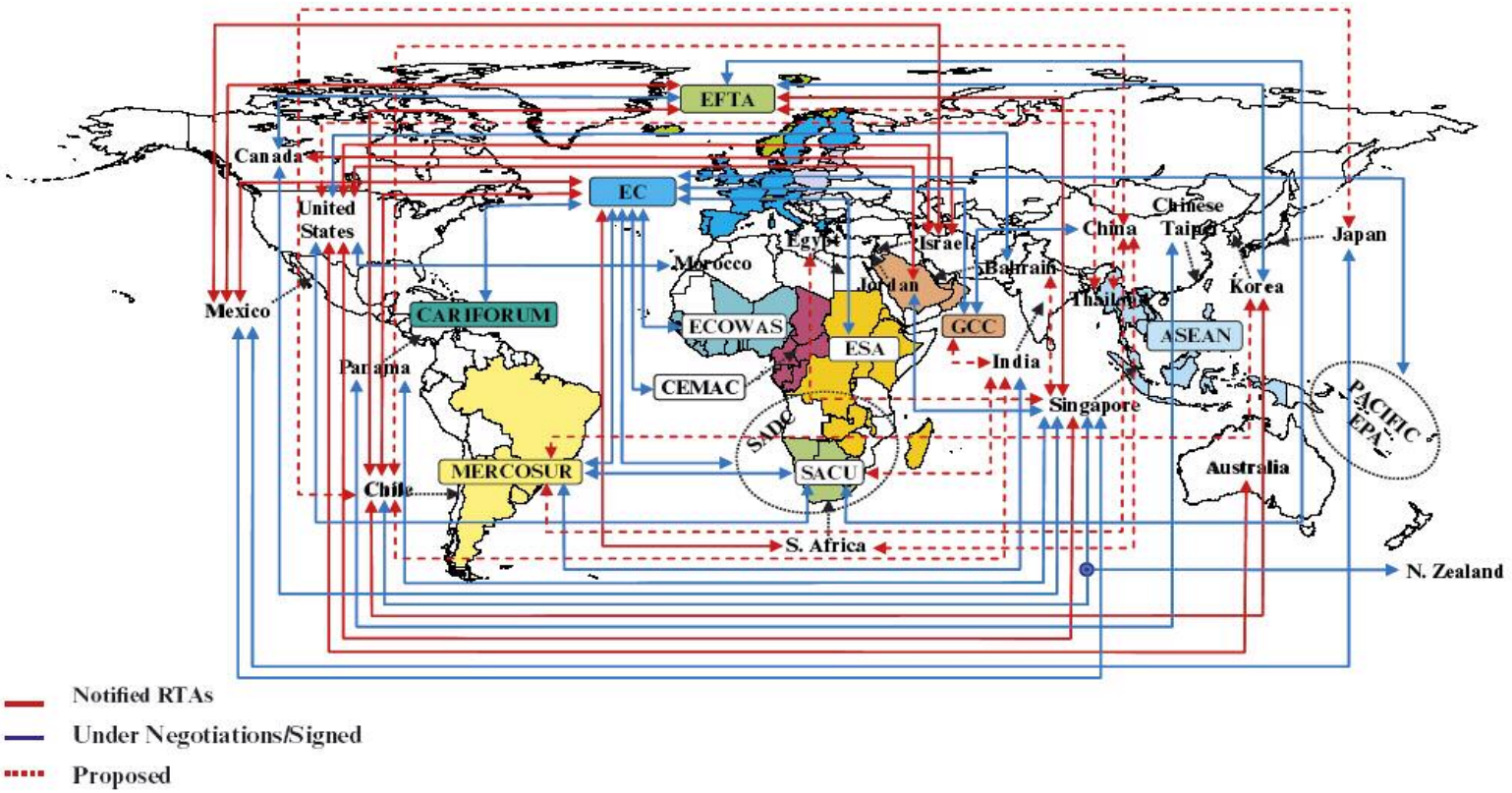
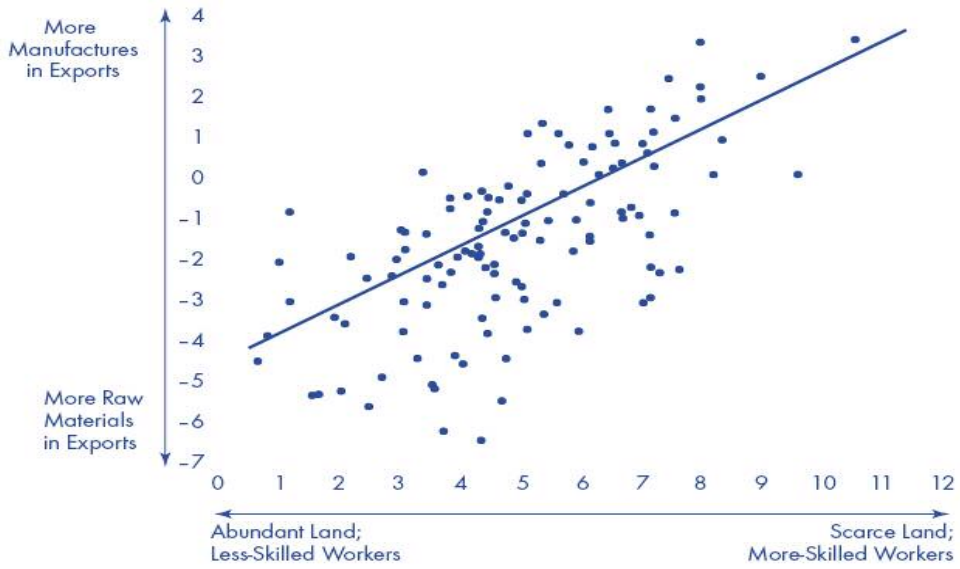


Figure 2.

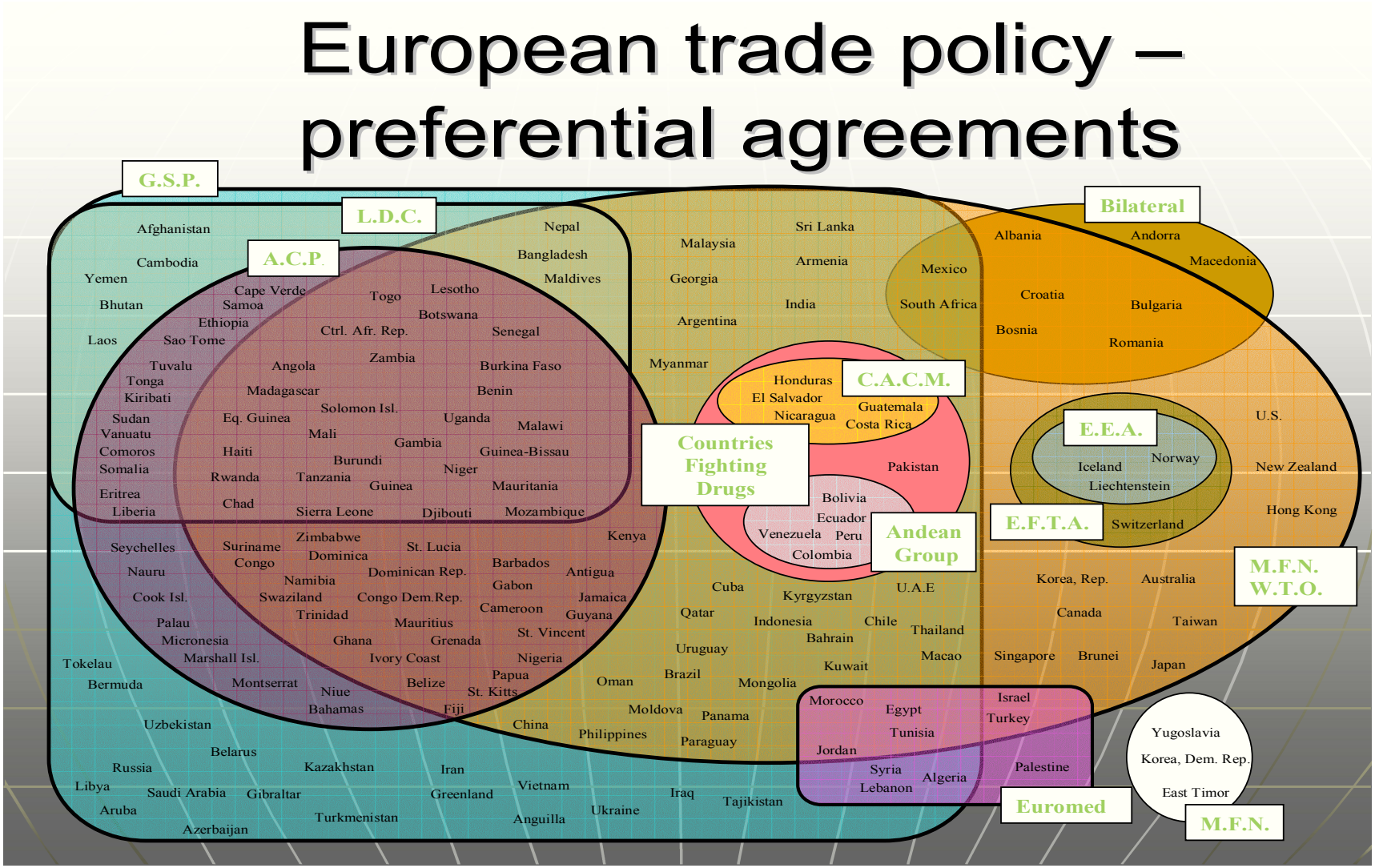

ATLANTIC OCEAN
NORWAY
SWEDEN
FINLAND
ESTONIA
LATVIA
LITHUANIA
North Sea
Baltic Sea
DENMARK
IRELAND
UNITED KINGDOM
GERMANY
POLAND
BELARUS
UKRAINE
CZECH REP.
AUSTRIA
HUNGARY
SWITZ.
FRANCE
Bay of Biscay
ROMANIA
SERBIA
BULGARIA
ITALY
SPAIN
PORTUGAL
GREECE
MALTA
TURKEY
CYPRUS
Mediterranean Sea
MOROCCO
ALGERIA
TUNISIA
SYRIA
IRAQ
IRAN
KAZAKHSTAN
RUSSIA
Black Sea
Caspian Sea
GEORGIA
AZERBAIJAN
1
2
3
4
5
6
7
8
9
10
11
More distant prospects
Albania (11), Bosnia (8), Macedonia (10), Serbia and Montenegro (9): Promised entry one day, but little progress.
Ukraine: Not a candidate, but hard to refuse if reform goes well.
Moldova (7): Very distant prospect, but hard to refuse if Ukraine accepted.
Georgia: Very distant prospect, but hard to refuse if Ukraine and Turkey accepted.
Belarus: Hard to refuse if democracy can be restored.
The European Union
Older members
Date joined
Belgium (2) 1958
France 1958
Germany 1958
Italy 1958
Luxembourg (3) 1958
Netherlands (1) 1958
Denmark 1973
Ireland 1973
United Kingdom 1973
Greece 1981
Spain 1986
Portugal 1986
Austria 1995
Finland 1995
Sweden 1995
Newer members
Date joined
Cyprus 2004
Czech Republic 2004
Estonia 2004
Hungary 2004
Latvia 2004
Lithuania 2004
Malta 2004
Poland 2004
Slovakia (4) 2004
Slovenia (5) 2004
Prospective members
Joining date
Bulgaria probably 2007
Romania probably 2007
Croatia (6) perhaps 2010
Turkey perhaps 2015
Source: Eurostat

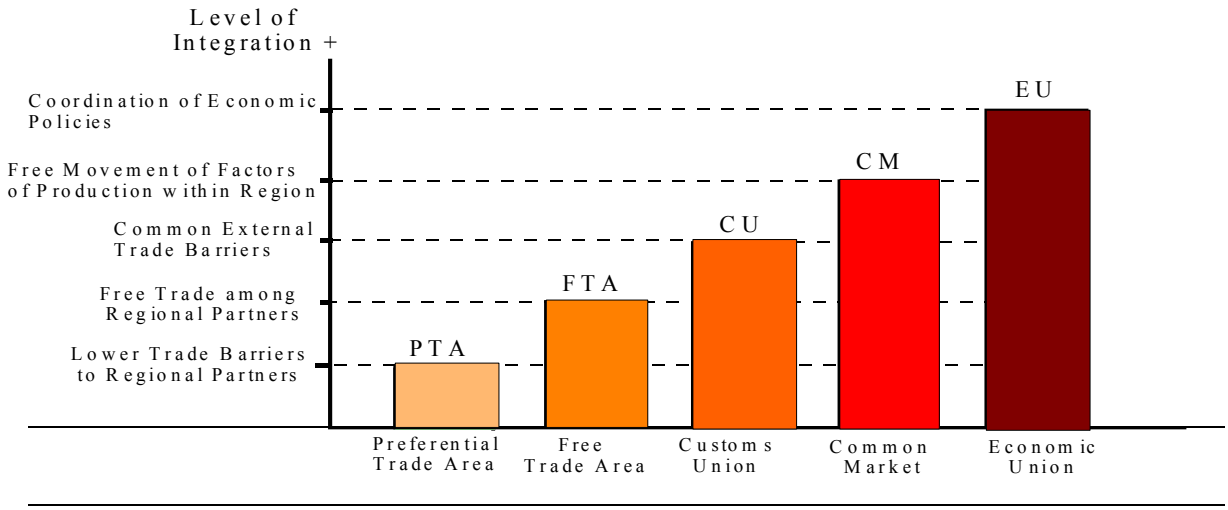


Empirical Evidence on the Heckscher-Ohlin Model

Ten Most-Capital-Intensive Industries	Ten Most-Unskilled-Labor-Intensive Industries
Cigarettes	*Gray iron foundries*
Flavoring extracts and syrups	*Industrial patterns*
Cereal breakfast foods	*Textile goods*
Wet corn milling	*Schiffli machine embroideries*
Dog and cat food	Footwear, except rubber
Agricultural chemicals	Leather gloves and mittens
Roasted coffee	Wood TV and radio cabinets
Distilled liquor, except brandy	Textile bags
Pharmaceutical preparations	*Special dyes, tools, jigs, and fixtures*
Industrial gases	*Ship building and repairing*
Ten Least-Capital-Intensive Industries	**Ten Least-Unskilled-Labor-Intensive Industries**
Textile goods	*Flavoring extracts and syrups*
Elevators and moving stairways	*Cigarettes*
Gray iron foundries	Periodicals
Industrial patterns	Book publishing
Rolling mill machinery	*Pharmaceutical preparations*
Ship building and repairing	*Agricultural chemicals*
Machine tools, metal forming types	*Industrial gases*
Special dyes, tools, jigs, and fixtures	*Wet corn milling*
Schiffli machine embroideries	*Roasted coffee*
Electronic computers	Electronic computers

European trade policy – preferential agreements





Chapter four: Mena & The textile and clothing sector

4.1 - Introduction

On 27 and 28 November 1995 the Euro-Mediterranean Conference of Ministers of Foreign Affairs held in Barcelona initiated the Euro-Mediterranean Partnership (Barcelona Process). The Barcelona Process has ambitious, long-term objectives, "turning the Mediterranean basin into an area of dialogue, exchange and cooperation guaranteeing peace, stability and prosperity".3 It rests on three pillars: a political and security partnership, economic and financial partnership, and social, human and cultural partnership. The establishment of a free trade area (FTA), by the year 2010 as an original target date, is one of the central economic objectives of the partnership as a catalyst for economic growth (Box 1).

The EU's initial partners in the Barcelona Process were Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, the Palestinian Authority, Syria, Tunisia, and Turkey. Since then, Libya has been given observer status at certain meetings as a future Mediterranean partner country. In addition, the EU and Turkey established a customs union on 1 January 1996, and Turkey officially became a candidate for EU membership in 1999. Cyprus and Malta joined the EU on 1 May 2004. Despite the changes in the status of Cyprus, Malta and Turkey, these countries are included in this study because they were original Barcelona partner countries in the reporting period 1995 to 2003.4 Furthermore, the fact that Cyprus, Malta and Turkey initiated far-reaching reforms at a relatively early stage distinguishes them from the other Mediterranean partners and allows interesting comparisons. After all, trade liberalisation and accompanying economic reforms, which create a favourable business climate and prompt more investment, are worth realising regardless of whether there is the prospect of EU membership liberalisation on the basis of preferential treatment granted by the EU. The customs union with Malta and Cyprus was eventually put in place when they entered the EU in 2004.

4.2 - Declaration 1995

Building on long standing (trade) relations between EU and MED countries and preferential treatment of MED products, particularly since the end-1970s, Euro-Mediterranean FTA is a core objective, and seen as key instrument to increase growth and improve living conditions Gradual realisation through bilateral Association Agreements (AA) and, in addition, free trade agreements between the MED partners, AAs have prompted progressive asymmetric tariff dismantling in industrial trade, and agricultural preferences for the MED
ENP offers a "stake in the internal market" Where do we stand?
Further diversification in the origin of investors, Europe still the major share of FDI input into MEDA (50% in projects) -North America stable at 18%, Gulf States and other MENA countries on the rise (15% against 11% in 2004 and a mere 6.5% in 2003), Asia (6%) and intra-MEDA (5%) also growing, Recipient countries in 2005, Turkey takes the lead due to large deals in the telecom field, Egypt – large projects in energy, banking and real estate, Israel – remarkable number of technological investments, Syria, Algeria, Morocco (€2 to 3 bn each, but different profiles), Small countries (Tunisia, Jordan, Lebanon) perform relatively

4.3 - The *three* pillars within the *Euro-Mediterranean Partnership*
(also known as the „Barcelona Process"): Political and security partnership, Economic and financial partnership, Social, human and cultural partnership.The main *aim* of the EMP is to promote economic growth. The main *instrument* for this is the creation of a Free Trade Area (FTA) by 2010.

4.4 The components of the EMP: The Euro-Mediterranean Association Agreements (EMAAs) aimed at liberalisation and cooperation in different areas;The financial support provided through MEDA and the European Investment Bank*,* How far the FTA will be reached depends on: Relative importancy of liberalization to other factors,Amount of liberalization achieved by the agreements

4.5 - Main MEDA assets & investors grow : inhabitants in 2025) Proximity of EU +Association Agreements +2010 Free Trade Zone, Moderate cost of labour (1/5th of EU average). Local resources & niches (from oil to brains…). The 20-35 year generation is a gold mine! A growing interest, but investors still hesitant. Fragmented Mediterranean market, Mixed image -economy / geopolitics / culture. Gaps (but improvements) in law enforcement, business attitude, or technical obstacles (logistics, training…), MEDA often absent of the investor short list, Many opportunities do exist now*,* Many ways of investing: JVs, privatisations, stakeholding, overseas branches, Local market, exports, off-shoring, services, infrastructure, R&D, According to our observatory , 686 foreign investment projects announced or started in 2005

4. 6 - Growth trend: 232 projets in 2003, 343 in 2004, 686 in 2005. A total capital investment figure of over €40bn in 2005 ! The quality of new investments is promising, Some strategic/ high profile/ high tech projects (R&D etc.) Projects coming from 50 different countries : mainly France (152 projects), United States (106) and Emirates (41 projects)
Presence of major companies (Intel, BP, Danone, Shell, Coca-Cola

MIPO results Encouraging trend*:* Diversification of investors (Gulf, OECD, emerging countries…) The main investors (FDI amounts) in MEDA are :Saudi Arabia (€6.8 bn), United States (€6.3 bn) and the United Kingdom (€6.1 bn**),** MEDA is becoming increasingly attractive. A wind of change The gap between MEDA and Central & Eastern Europe seems to be closing. MEDA recovery is an on-going process

4.7 - Determinants of FDI Inflows

Various motivations of FDI were put forward in the literature. The eclectic theory of FDI groups them into three categories (Dunning 1981 and 1988). First, ownership-specific advantages that allow firms to compete with the other firms in the markets it serves regardless of the disadvantages of being foreign. Second, transaction costs associated with trade and licensing that make the internalized transactions through FDI more efficient. Third, location advantages that make the chosen foreign country a more attractive site for FDI than the others. Given the objective of the study, we will focus on the latter. We group country's advantages into three categories: basic economic factors, trade and foreign exchange policy and other aspects of the business climate. FDI inflows can represent additional resources a country needs to improve its economic performance. By increasing capital stock, FDI can increase country's output and productivity through a more efficient use of existing resources and by absorbing unemployed resources. For instance, De Gregorio (1992) shows, in a panel of 12 Latin American countries, that FDI is about three times more efficient than domestic investment (see also UNCTAD, 1992 and Blomstrom et al, 1992). FDI can also act as a catalyst for local investment by complementing local resources and providing a signal of confidence in investment opportunities. Agosin and Mayer (2000),

4.8 **- Basic Economic Factors**

An early survey by Agarwal (1980) summarized the basic economic determinants of country attractiveness with respect to FDI: the difference in the rate of return on capital across countries, portfolio diversification strategy of investors and market size of the host country. The difference in the rate of return is dependent on incentives for foreign investors and supply of cheap labor. Empirical evidence shows that the effect of incentives provided by the host country on FDI is only marginal however. Agarwal explains this unexpected finding by the fact that incentives are generally accompanied by a set of restrictions and requirements. The supply of cheap labor appears as a more convincing explanation of FDI. Overall, empirical evidence on the relationship between inter-country differences in the rates of return and FDI does not provide any conclusive results. This ambiguous finding is due, according to Agarwal, to statistical and conceptual problems. Theoretically, FDI is a function of expected profits but available data are on reported profits. In addition, reported profits may not be similar to actual profits since transactions between the parent company and its affiliates are subject to intra-company pricing rather than to market pricing.

The portfolio diversification hypothesis stresses the fact that investors select their locations taking into account both the expected profits and the perceived risk. Portfolio diversification helps reducing the total risk as long as returns are highly correlated within the country and weakly correlated between the home and the host countries. The empirical evidence in favor of this hypothesis remains weak. Some authors attempted to understand why multi-national companies tend to contribute more to FDI than to portfolio investments which are more likely to provide better instrument for geographical diversification. They argued that this

preference might be due either to the absence of organized security markets (the case of LDCs) or to presence of high inefficiencies on these markets when they exist. this may reflect the outward orientation of foreign firms located in this region. FDI inflows are also found to be more responsive to wages than to costs of capital including taxes.

4.9 - Trade and foreign exchange policy

The impact of trade and foreign exchange policy was examined, among others, by Hufbauer et al. (1994), Froot and Stein (1991), Cushman (1985) and Goldberg and Kolstad (1995). Hufbauer et al. (1994) show that the size and openness of the host country are important determinants of FDI flows from the United States and Japan. The relationship between FDI flows and exchange rate was examined by Froot and Stein (1991) who found that FDI inflows are negatively correlated with the value of the dollar. This implies that a depreciated currency can stimulate in buying control of productive corporate assets. Cushman (1985) focussed on the effects of real exchange rate risk and expectations on FDI. The results show significant reductions in US direct investment associated with increases in the current real value of foreign exchange, and very strong reductions associated with the expected appreciation of real foreign exchange. Goldberg and Kolstad (1995) explore the implications of short-term exchange rate variability on FDI flows and support the hypothesis that volatility contributes to the internationalization of production.

Some studies focused on other policies such as grants, subsidies, tax abatement, loan's guarantees and interest subsidies. Gubert and Mutti (1991) found that incentive schemes designed to attract FDI flows were effective in altering foreign investment decisions. Brewer (1993) points out that these policies can either increase or decrease market imperfections and therefore increase or decrease levels of FDI. Loree and Guisinger (1995) suggest that the effect of policies on FDI may differ between developing and developed countries. Finally, Castanaga et al (1998) found that exchange rate distortions in the host country do not have a negative effect on FDI flows while growth expectations exert a positive effect and corruption a negative one.

4.10 - Other aspects of the business climate

Economists generally acknowledge the important role of infrastructure in stimulating growth and investment. Wheeler and Mody (1992) found that infrastructure quality is an important determinant of FDI inflows to LDCs. Labor costs and the existing foreign investment also play an important role. Their results also suggested that incentive variables to attract more FDI flows such as tax breaks or short run grants have only a limited effect because transfer pricing and deduction of foreign taxes provide alternative ways to reduce the amount of paid taxes. Richaud et al (1999) provided additional support to the positive impact of infrastructure on FDI. Drawing on endogenous growth theory, they set up a four-equation model to investigate the impact of infrastructure on growth, trade, domestic investment and FDI. Their estimates confirmed the positive impact of infrastructure on FDI.

Political instability is expected to have a negative effect on FDI flows through its impact on profit uncertainty. Root and Ahmed (1979) tested for the effect of economic, social and political variables on FDI. They found that four economic (per capita GDP, GDP growth rate, economic integration, importance of transport, commerce and communication) one social (degree of urbanization) and one political (the number of constitutional changes in government leadership) variables have an effect on FDI. Schneider and Frey (1985) reexamined the issue and concluded that both economic and political factors are crucial for

FDI flows to LDCs. As far as economic factors are concerned, FDI reacts positively to per capita GNP and negatively to the balance of payments deficit. Growth of GNP and the workers' skill level are found to have weak effects on FDI decisions. Regarding political determinants, the amount of bilateral aid coming from Western countries has a strong positive effect on FDI flows, while the governments ideological position (right or left wing position) does not have any significant effect.
The role of institutions is crucial in terms of commitments to and enforcement of rules. Corruption is generally put at the heart of the non-enforcement of rules in LDCs. It is found to depress growth and domestic investment and to contribute to an unfair wealth distribution (Mauro, 1995). Wei (2000) carefully examined the relationship between FDI and corruption. He used three measures of corruption, all of which are based on surveys of international entrepreneurs. The estimation results showed the existence of a negative relationship between corruption level in the host country and inward foreign direct investment. Henisz (2000a) examined the effect of commitment to rules on growth and investment. He focused on the effect of frequent or arbitrary changes in taxation, regulation and other relevant economic policies. He found that commitment to rules has a statistically and economically significant impact on growth and that this result is robust to various specifications. Henisz (2000b) focused on the effects of political hazard and contractual hazard on investment decision of multinational corporations. The results confirm that firms are more likely to enter wealthier countries with large population and credible political rules.

4 .11 - Trade and Foreign Exchange Liberalization and Investment Climate in the MENA Countries

In this section, we use the econometric results to assess the respective impact of liberalization and investment climate on the low attractiveness of the MENA countries in term of FDI. The impact of liberalization will be assessed using the S-W index. Using equation (2) (specification 5) we find that FDI flows to the region could have been of 2.3% of GDP (instead of 1.2%) during the 1990s, if trade and foreign exchange liberalization had reached the level of East Asia. In the case of *Algeria*, *Egypt*, *Iran* and *Syria*, FDI flows to GDP could have reached respectively 1.8%, 2.8%, 1.5% and 2.4%.

Impact of trade and foreign exchange liberalization is even stronger in the case of FDI in the manufacturing sector.These flows have been very high in East Asia where trade and foreign exchange reforms have always been significant. If MENA had undertaken the same level of reforms, FDI in manufacturing could have increased by 1.2 % of GDP (for a lower level than total FDI).

Similar conclusions can be drawn for physical infrastructures (proxied by the number of fixed phones). Identically, the gap with East Asia explains significantly the deficit in FDI flows to the region. In the 1990s, if the MENA countries had increased their infrastructures to the level of the East Asian economies, FDI flows could have reached 2.5% of GDP (compared to 1.2%). As far as countries' experience is concerned, *Yemen*, *Morocco*, *Algeria* and *Egypt* have shown a low development in physical infrastructures. In the case of these countries, a level of equipment similar to the one of East Asia would have boost FDI which could have increased by 1.4 to 1.7% of GDP.

Improvement in either economic or political stability gives similar impact to the one of liberalization. In the 1990s, if the MENA countries have had comparable records to the East Asia in terms of economic or political stability, FDI flows to GDP could have increased by

around 1.1 percentage point. Assuming that sound governance could have improved both indicators, the total impact on FDI becomes twice the one of liberalization. As far as countries' experience is concerned, the largest impact concerns *Algeria.* The impacts for the other countries are comparable.

Finally, if trade and foreign exchange liberalization, development of infrastructures, and sound governance are considered at the same time, FDI flows to MENA could have significantly catch up with East Asia.

4. 12 - FDI in the MENA Countries

The chapter assesses the relative importance of trade and foreign exchange liberalization, infrastructure availability and economic and political stability in increasing Middle East and North African (MENA) countries attractiveness with respect to FDI. The analysis is conducted for total FDI and for FDI in manufacturing. The results show that trade and foreign exchange liberalization, infrastructure availability and sound economic and political conditions increase FDI inflows. Their effects are much higher for FDI in the manufacturing sector than for total FDI. This result is robust to alternative indicators of trade and foreign exchange liberalization, and to change in the specification. The message to MENA's policy makers is twofold. First, efforts toward trade and foreign exchange liberalization should be initiated or further increased in order to make the region attractive to foreign investors. Second improvements in other aspects of the investment climate are important complements to liberalization and result in additional and sensitive increase of FDI inflows.

The creation of a Euro-Mediterranean Free Trade Area (EMFTA) as a catalyst for economic growth is a central objective of the Barcelona Declaration, which was adopted by the European and Mediterranean Foreign Affairs Ministers in 1995. The EMFTA shall be realised gradually through Euro-Mediterranean Association Agreements and free trade agreements between the Mediterranean partners. The Barcelona Declaration built on earlier cooperation between the EU and the Mediterranean partner countries, which included a unilateral opening of EU markets mainly for industrial products from the Mediterranean by the end of the 1970s. However, most Mediterranean countries started opening their markets for industrial products from the EU only recently. The establishment of complementary free trade areas among the Mediterranean countries is only just beginning.
In general, partner countries which committed early to trade liberalisation and accompanying economic reforms under the terms of the Association Agreements also experienced a better trade performance with the EU than their peers. In spite of this, only a few Mediterranean countries increased their market share of world exports to the EU from 1995 to 2003, while the EU's market share in the Mediterranean remained fairly constant. This reflects the asymmetric trade liberalisation and the possibility that exporters in some Mediterranean countries were operating in unsatisfactory business climates. There is evidence of a considerable unexploited trade potential between EU and Mediterranean countries but trade liberalisation in the Mediterranean countries needs a complementary strengthening of the private sector and business environment.

The Barcelona Declaration also stresses the importance of improving the domestic business climate as a basis for investment, both domestic and foreign. Countries which committed themselves early to reforms by Association Agreements were able to attract more foreign direct investment in relation to their GDP than their peers. Yet, FDI inflows into the

Mediterranean countries remain relatively low. In general, EU exports and FDI towards the Mediterranean countries are positively correlated. This indicates the potential for deeper EU-Mediterranean integration in those cases in which FDI is predominantly driven by a dislocation of the production chain according to cost criteria rather than by market-seeking aspects.

Table 1: Basic agreements between the EU and MPC

	Association Agreement	Cooperation Agreement	Euro-Mediterranean Association Agreement			ENP Action Plan
	into force		signed	trade provisions into force	into force	
Algeria	-	1 November 1978	22 April 2002	-	pending	-
Egypt	-	1 November 1978	25 June 2001	1 January 2004	1 June 2004	-
Israel	-	1975	20 November 1995	1 January 1996	1 June 2000	x
Jordan	-	1 November 1978	24 November 1997	-	1 May 2002	x
Lebanon	-	1 November 1978	17 June 2002	1 February 2003	1 March 2003[a]	-
Morocco	-	1 November 1978	26 February 1996	-	1 March 2000	x
Palestinian Authority	-	-	24 February 1997	-	1 July 1997[a]	x
Syria	-	1 November 1978	pending	-	-	-
Tunisia	-	1 November 1978	17 July 1995	-	1 March 1998[b]	x
Cyprus[c]	1 June 1973	-	-	-	-	-
Malta[c]	1 April 1971	-	-	-	-	-
Turkey[d]	1 December 1964	-	-	-	-	-

Source: European Commission.

[a] Interim Agreement.

[b] Tunisia has unilaterally anticipated the implementation for industrial products from 1 January 1996.

[c] A customs union was one of the long-term objectives of the Association Agreement but did not enter into force before the country became an EU Member State on 1 May 2004.

[d] A customs union between the EU and Turkey entered into force on 1 January 1996. Turkey is a recognised candidate for EU Membership since 1999.

Israel was a frontrunner in another group of countries which signed Cooperation Agreements with the EU. Its 1975 Cooperation Agreement followed up on an earlier agreement dating back to 1970. The 1975 Agreement with Israel already envisaged a free trade area for industrial goods with reciprocal liberalisation. In that respect it reflected the advanced development of the Israel's economy and was more comprehensive than the Cooperation Agreements with the other Mediterranean partners, which entered into force in 1978. However, these Cooperation Agreements included preferential trade arrangements granted by the EU.5 Customs duties on industrial products were phased out one year after the signature of the Agreements, and quantitative restrictions were abolished, apart from agricultural products and certain textile products. In addition, tariff concessions were granted for certain agricultural products.
In exchange for this, the EU obtained Most Favoured Nation (MFN) status. But the Mediterranean countries were still entitled to introduce new customs duties or quantitative restrictions.

Liberalisation on the basis of preferential treatment granted by the EU. The customs union with Malta and Cyprus was eventually put in place when they entered the EU in 2004. Israel was a frontrunner in another group of countries which signed Cooperation Agreements with the EU. Its 1975 Cooperation Agreement followed up on an earlier agreement dating back to 1970. The 1975 Agreement with Israel already envisaged a free trade area for industrial goods with reciprocal liberalisation. In that respect it reflected the advanced development of the Israel's economy and was more comprehensive than the Cooperation Agreements with the other Mediterranean partners, which entered into force in 1978. However, these Cooperation Agreements included preferential trade arrangements granted by the EU.5 Customs duties on industrial products were phased out one year after the signature of the Agreements, and quantitative restrictions were abolished, apart from agricultural products and certain textile products. In addition, tariff concessions were granted for certain agricultural products. In exchange for this, the EU obtained Most Favoured Nation (MFN) status. But the Mediterranean countries were still entitled to introduce new customs duties or quantitative restrictions.

"The free-trade area will be established through the new Euro-Mediterranean Agreements and free trade agreements between partners of the European Union. The parties have set 2010 as the target date for the gradual establishment of this area which will cover most trade with due observance of the obligations resulting from the WTO.

With a view to developing gradual free trade in this area: tariff and non-tariff barriers to trade in manufactured products will be progressively eliminated in accordance with timetables to be negotiated between the partners; taking as a starting point traditional trade flows, and as far as the various agricultural policies allow and with due respect to the results achieved within the GATT negotiations, trade in agricultural products will be progressively liberalized through reciprocal preferential access among the parties; trade in services including right of establishment will be progressively liberalized having due regard to the GATS agreement.
The participants decide to facilitate the progressive establishment of this free-trade area through: the adoption of suitable measures as regard rules of origin, certification, protection of intellectual and industrial property rights and competition; the pursuit and the development of policies based on the principles of market economy and the integration of their economies taking into account their respective needs and levels of development; and the adjustment and modernization of economic and social structures, giving priority to the promotion and development of the private sector, to the upgrading of the productive sector and to the establishment of an appropriate institutional and regulatory framework for a market economy. They will likewise endeavour to mitigate the negative social consequences which may result from this adjustment, by promoting programmes for the benefit of the neediest populations; the promotion of mechanisms to foster transfers of technology."
Also "… the participants … affirm that regional cooperation on a voluntary basis, particularly with a view to developing trade between the partners themselves, is a key factor in promoting the creation of a free-trade

"The establishment of a free trade area in accordance with the principles contained in the Barcelona Declaration is an essential element of the Euro-Mediterranean partnership. Cooperation will focus on practical measures to facilitate the establishment of free trade as well as its consequences, including: • harmonizing rules and procedures in the customs field, with a view in particular to the progressive; introduction of cumulation of origin; in the

meantime, favourable consideration will be given, where appropriate, to finding ad hoc solutions in particular cases; harmonization of standards, including meetings arranged by the European Standards Organisations; elimination of unwarranted technical barriers to trade in agricultural products and adoption of relevant measures related to plant-health and veterinary rules as well as other legislation on foodstuffs; cooperation among statistics organizations with a view to providing reliable data on a harmonized basis; possibilities for regional and subregional cooperation progressive tariff dismantling in industry and agricultural preferences. Moreover, other work on trade and trade-related matters has been launched, such as the diagonal cumulation of origin within the Euro-Mediterranean area, services liberalisation at regional level and, more prudently, trade facilitation and approximation of product legislation and standards. In parallel, partners have been requested to conclude South-South free trade areas among themselves as an essential complement of the regional liberalisation efforts.

Trade liberalisation under the terms of the Association Agreements is reciprocal but asymmetric. In addition to the duty- and quota-free access for all industrial products, which the EU granted already in the Cooperation Agreements, the Mediterranean countries will open their markets gradually over a transitional period of up to 12 years.7 In principle, the degree of liberalisation of industrial trade depends on product groups, and in some ountries it begins only after a transition of several years. However, Tunisia has anticipated the implementation of the trade liberalisation for industrial products on 1 January 1996, before the Association Agreement entered into force.
The envisaged liberalisation of agricultural trade is still very limited but will be considered on the basis of revision clauses included in the Association Agreements. Even more important is the new approach to regional liberalisation of agricultural trade shortly to be presented by the European Commission. The Association Agreements also include a commitment to negotiations on services liberalisation not later than five years after they enter into force. This time has elapsed in the case of the West Bank and Gaza, and Tunisia. The possibility to start services negotiations is foreseen in the Framework Protocol adopted at Euro-Mediterranean Ministers level in 2004 and likely to occur soon.

The European Neighbourhood Policy, launched in 2003, strengthens the Association Agreements through bilateral Action Plans. They build on the above-mentioned initiatives in the Euro- Mediterranean context and identify joint priority actions, in particular in trade and trade-related areas, which are to be implemented in the short and medium term. By the end of 2004 Action Plans had been adopted with Israel, Jordan, Morocco, the Palestinian Authority and Tunisia.
Furthermore, some Mediterranean partners had committed themselves to South-South subregional trade liberalisation in addition to the bilateral trade liberalisation with the EU. In February 2004 Egypt, Jordan, Morocco and Tunisia signed a regional free-trade agreement. The original deadline announced in the Barcelona Declaration was 10 years.

(Agadir Agreement) which creates an important link between Maghreb and Mashreq countries. Morocco, the Palestinian Authority, Tunisia and Syria also concluded free-trade agreements with Turkey.
A simple comparison of the average MFN tariffs shows that countries which started liberalising trade with the EU at an early stage, such as Cyprus, Malta, Turkey, and later Israel and the Palestinian Authority, also applied substantially lower average tariffs than their peers; apart from Egypt and Syria, which followed only in 2004, all countries lowered their average tariffs at the beginning of the new millennium. The reduction in Lebanon was

particularly pronounced. However, Algeria, Lebanon, Syria, and the West Bank and Gaza are not WTO members. They are therefore not obliged to grant MFN status to each trading partner.

The reason for the poor export and FDI performance in the region has been related to prolonged application of inward-looking strategies based on import-substitution (Nabli and De Kleine, 2000). This is why, during the 1980s, some of the MENA countries engaged in a process of economic reform, involving a more outward orientation of their economies, the lowering of trade barriers, privatization of many industries and reform of the foreign-exchange market. However, other MENA countries are still lagging behind (Nabli and Veganzones, 2003). Moreover, international evidence (see Dasgupta et al, 2002) suggests that trade and foreign exchange policies might not be sufficient and companion policies would be needed to further increase the attractiveness of a country. Such policies aim at strengthening the investment climate. They include the availability of adequate infrastructure and the quality of the economic, the political and the institutional framework.

Whether the reforms undertaken by some MENA countrie can help improving their record in term of FDI attractiveness and can improvement of other aspects of the business climate (physical infrastructures and political and economic stability) further increase, and to what extent, FDI attractiveness of the region. For this purpose, an econometric model of the determinants of FDI has been set up and estimated over a large sample of developing countries. The results show that countries having undertaken trade and foreign-exchange market reforms are able to attract more FDI. The improvement in other aspects of the business climate can result in an increase of FDI inflows that is comparable to the one resulting from trade and foreign exchange policies.

The chapter goes a step further by conducting a similar exercise using FDI in manufacturing instead of total FDI. This is motivated by two facts. First, in some countries FDI may be due to natural resource abundance and their inflows may be little affected by the business climate. Second, the manufacturing industry is more conductive to growth than agriculture or mining. Although caution is recommended due to the limited number of countries in the sample (only 21), the results suggest that the impact of trade and foreign exchange market reforms and of improvement of the business climate is higher for FDI in manufacturing than for total FDI.

4.13 - Financing programs & investors size:

A cornerstone of the EMP is a financial support for the whole region through MEDA. MEDA is comparable to the PHARE (Eastern Europe) and TACIS (Central Asia) programmes. MEDA replaced previous bilateral aid protocols. The Funds:
MEDA I (1995-1999) 3,435 million €
MEDA II (2000-2006) 5,350 million €
The newer programme (2007- 2013) 15000 million €
MEDA pursues the creation of an EMFTZ by 2010 by supporting mainly structure adjustment programmes and economic transition programmes
The biggest difference of the new European Mediterranean Association Agreements (EMAAs) with former agreements from the 1970s is the reciprocity

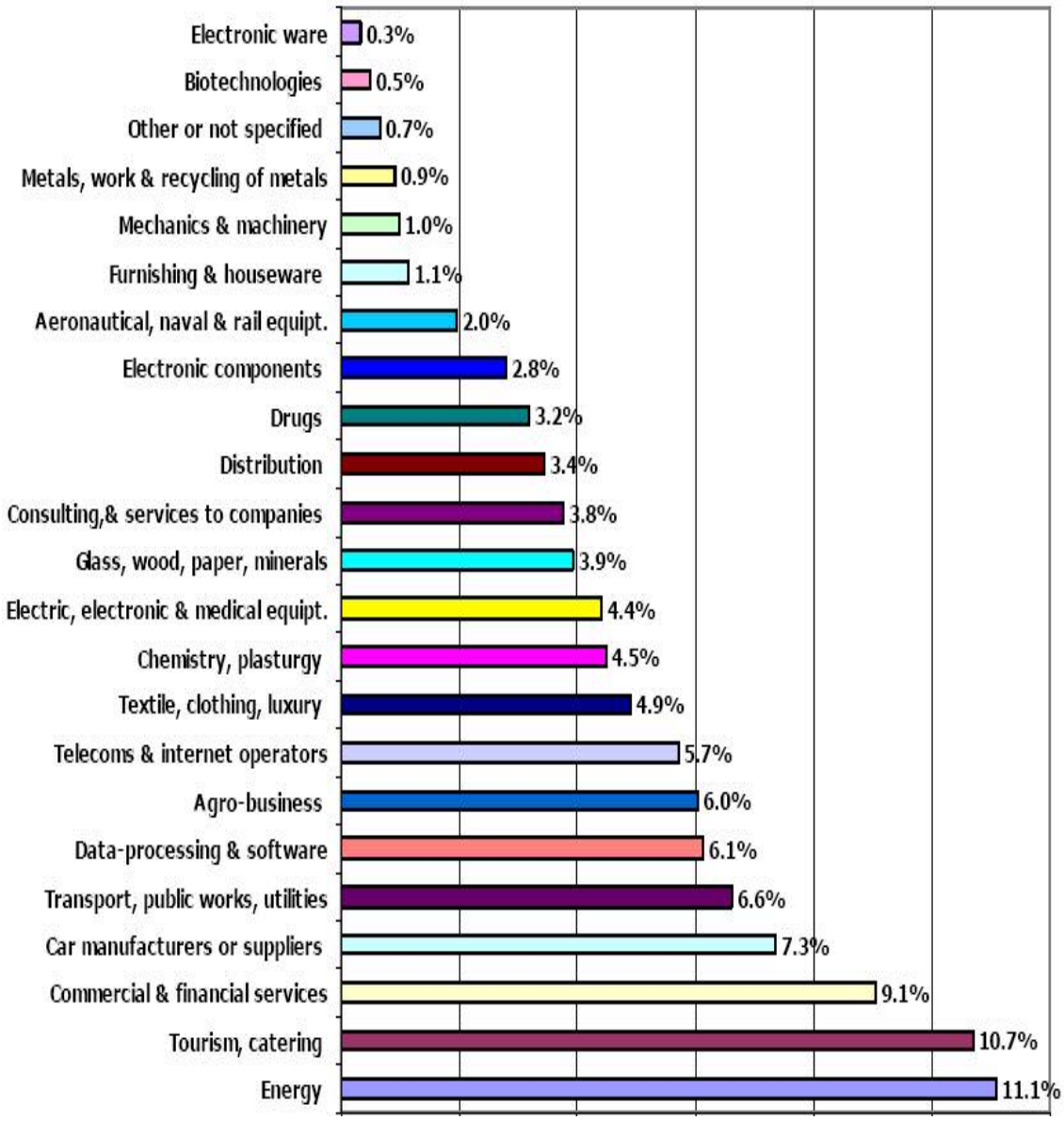
In addition, the European Investment Bank has launched in 2002 the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) for promoting private sector development.Total loans in 2004: 2,2 billion €.

The main competitor of the EU, the US, has already FTAs with Israel (1985) and Jordan (2002) and in 2003 launched a plan to create the Middle East Free Trade Area (MEFTA) by 2013A number of size able investments in the energy sector (Algeria, Egypt, Tunisia, Syria etc.) Big real estate and/or tourism projects. Egypt, Jordan, Lebanon, Morocco, Syria…
Originating in particular from the Gulf States, Several major privatisation operations, e. g. in Turkey. 3 deals for Turk Telekom, Telsim & Turkcell = US$ 14 bn
The *Arab investors* (Gulf etc.) are shifting part of their investments from the Americas to

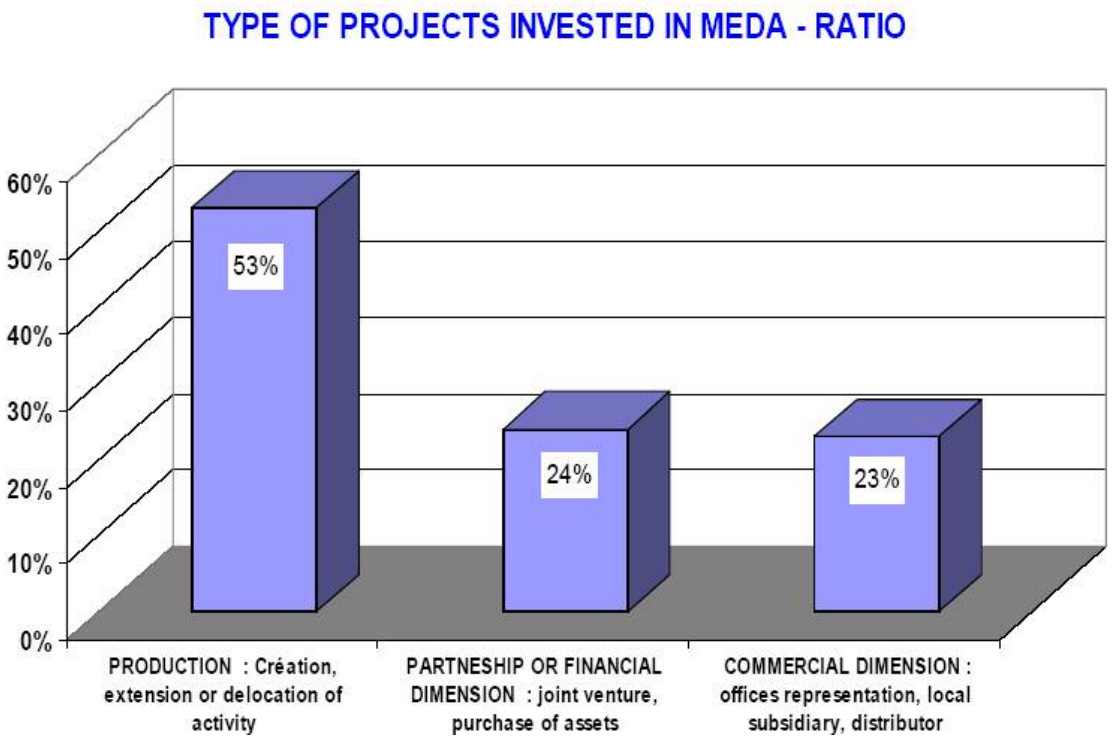
4.14 - MEDA
Complete transformation of the banking sector. Opening of a number of agencies and takeover of banking networks by large European banks. And IPAs' and ANIMA's efforts…
Major trumps of the MED & 4 reasons to invest in EuroMed
At civilization crossroads: (geo-strategic region. Common living space)
A talented & productive labour force: (employment deficit in 2010 in EU. Trelingual arabic,english,frensh)
Positive changes underway: (Macro-economic reforms in banking and financial markets. Privatization programs. Euromed. Agreements.
Life style & civilization: (religion, culture and way of life)
Diversification of investors (Gulf, OECD emerging countries…)
The main investors (FDI amounts) in MEDA are : Saudi Arabia (€6.8 bn), United States (€6.3 bn) and the United Kingdom (€6.1 bn). MEDA is becoming increasingly attractive, A wind of change ,The gap between MEDA and Central & Eastern Europe seems to be closing,

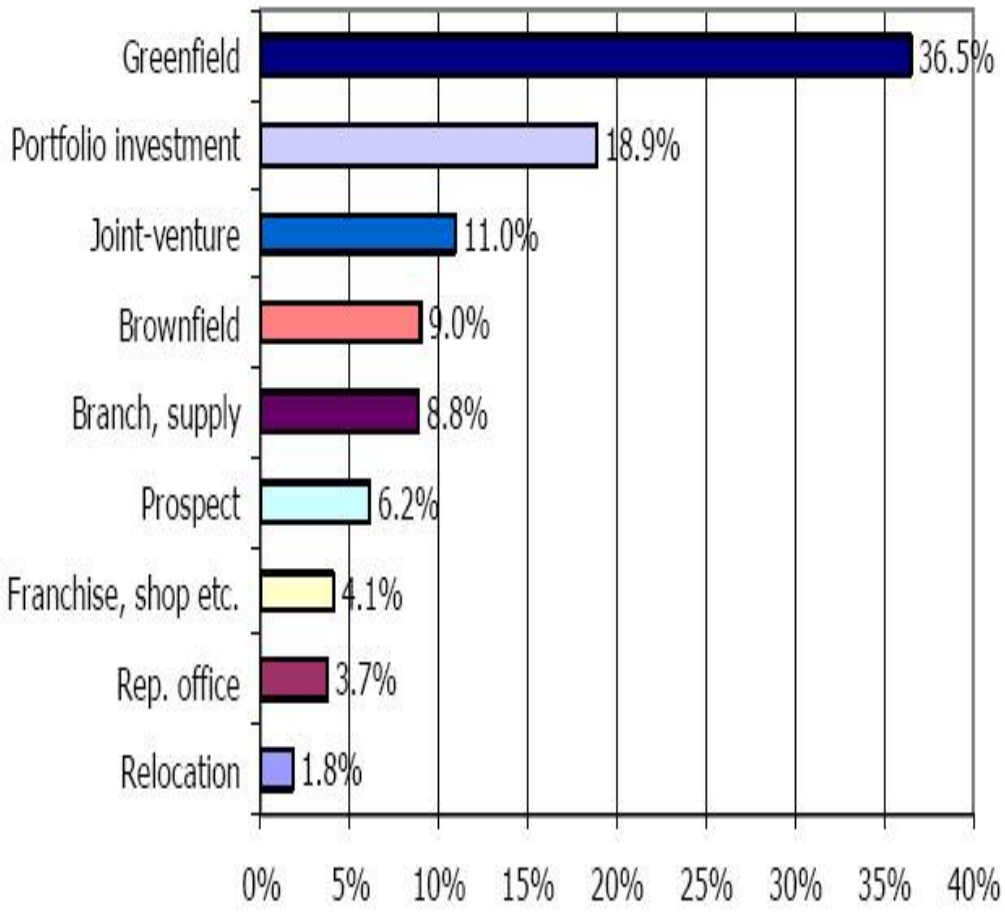
4.15 MEDA recovery is an on-going process
1-A market with 720 milion inhabitants in 2025: (young& educated. Migration to coastal areas (*7 in 50 years). Leading partners with EU .
2-Towards a large free trade zone 2010: (conference of 1995 Barcelone. Trade flow to the benefit capital. Reorientation towards industries and territories activities.
3-A favorable business climate: (Modernization of infrastructures and public services. Banking, telecommunication. Economic cooperation with Europe. Cluster Policies.
4-North/South cooperation (Capital saving exceess (30 bn/year). Labor-force integration. Relocation from Europe.

4.16 - Main growing activites: Energy, Infrastructure facilities (transports, ports & airports, sewage treatments..) Consumer goods & distribution (agro-food, franchises, logistics. I.T (personal computing, software, media contends.Tourism. Services to business (expertizes, counseling..)
Health (medical devices and services to social housing)


Electronic ware 0.3%
Biotechnologies 0.5%
Other or not specified 0.7%
Metals, work & recycling of metals 0.9%
Mechanics & machinery 1.0%
Furnishing & houseware 1.1%
Aeronautical, naval & rail equipt. 2.0%
Electronic components 2.8%
Drugs 3.2%
Distribution 3.4%
Consulting,& services to companies 3.8%
Glass, wood, paper, minerals 3.9%
Electric, electronic & medical equipt. 4.4%
Chemistry, plasturgy 4.5%
Textile, clothing, luxury 4.9%
Telecoms & internet operators 5.7%
Agro-business 6.0%
Data-processing & software 6.1%
Transport, public works, utilities 6.6%
Car manufacturers or suppliers 7.3%
Commercial & financial services 9.1%
Tourism, catering 10.7%
Energy 11.1%

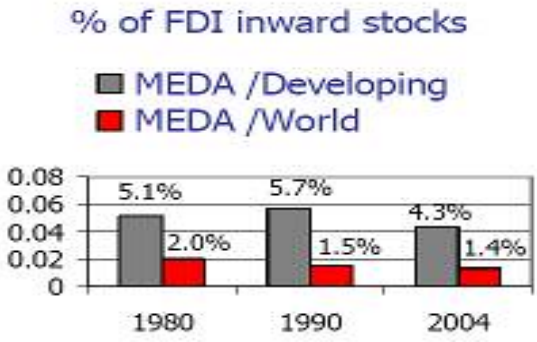
FDI per type

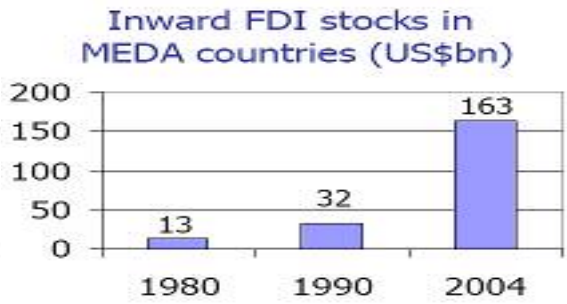

TYPE OF PROJECTS INVESTED IN MEDA - RATIO
60%
50%
40%
30%
20%
10%
0%
53%
24%
23%
PRODUCTION : Création, extension or delocation of activity
PARTNESHIP OR FINANCIAL DIMENSION : joint venture, purchase of assets
COMMERCIAL DIMENSION : offices representation, local subsidiary, distributor


Greenfield
36.5%
Portfolio investment
18.9%
Joint-venture
11.0%
Brownfield
9.0%
Branch, supply
8.8%
Prospect
6.2%
Franchise, shop etc.
4.1%
Rep. office
3.7%
Relocation
1.8%
0%
5%
10%
15%
20%
25%
30%
35%
40%

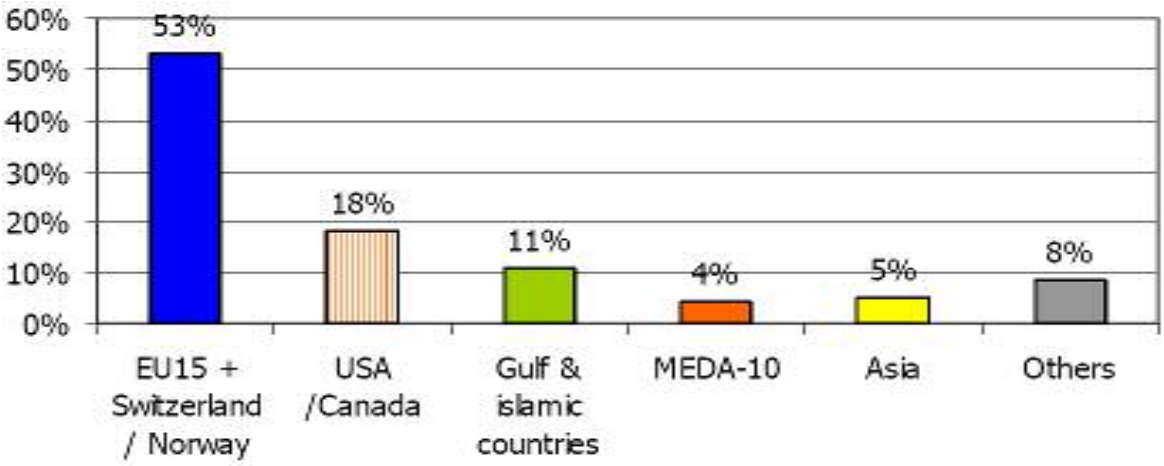
The Trend of FDI in the MENA

More added value projects. 50% of the world top 40 Cies. 10 projects over 500 Mn €

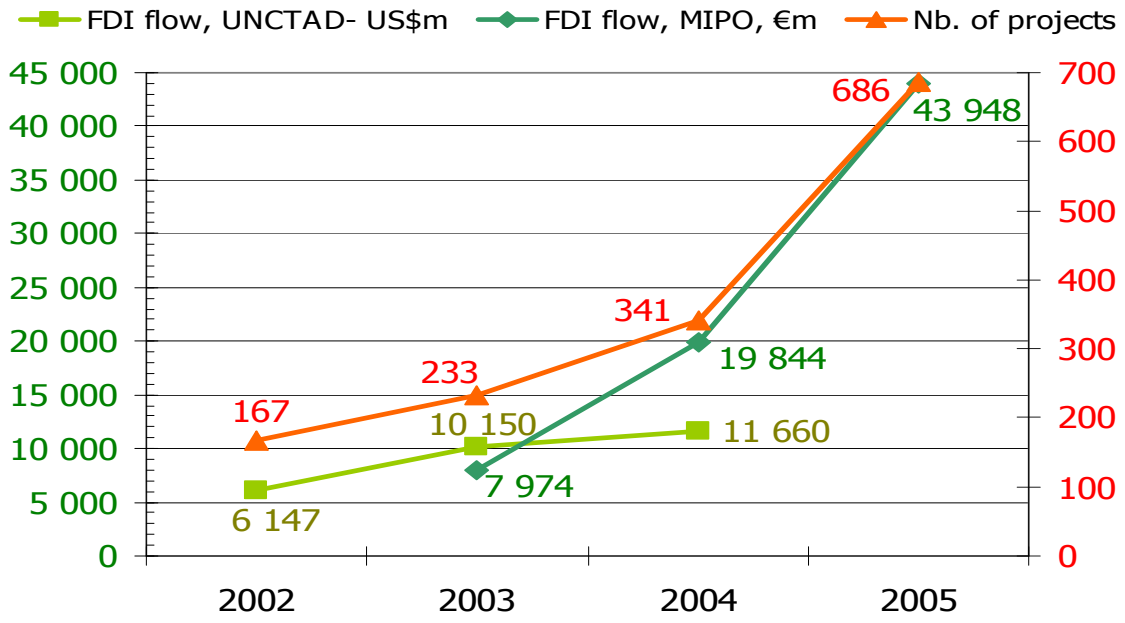




Who's playing in MED?



FDI attraction, MEDA region



A strong take-off in 2005

Moroco	118 Projects	Agri – food, industrial sector & ICT
Algeria	93	Energy, Banks & Services
Tunisia	78	Energy, telecom, Textile services.
Malta	5	Druges, Logistics, Banks.
Turkey	73	Telecoms, automobile, Banks, Agri-food
Cyprus	7	Telecoms, services, agri – food
Egypt	101	Energy, chemicals, banks, tourism.
Palestine Auth.	5	Banks, ICT
Syria	40	Energy, tourism, banks, banks, Agri- food
Lebanon	26	Tourism, ICT, real estate.
Israel	94	Software, electronic, Banks
Jordan	46	Tourism, Banks, Software, real estate.

4.17 - Why such an increase?

A number of sizeable investments in the energy sector (Algeria, Egypt, Tunisia, Syria etc.)
Big real estate and/or tourism projects: Egypt, Jordan, Lebanon, Morocco, Syria…Originating in particular from the Gulf States
Several major privatisation operations, e. g. in Turkey
3 deals for Turk Telekom, Telsim & Turkcell = US$ 14 bn
The *Arab investors* (Gulf etc.) are shifting part of their investments from the Americas to MEDA; Complete transformation of the banking sector
Opening of a number of agencies and takeover of banking networks by large European banks and IPAs' and ANIMA's efforts…

4.18 - Donor & recipient countries in 2005

Further diversification in the origin of investors Europe still the major share of FDI input into MEDA (50% in projects) -North America stable at 18% Gulf States and other MENA countries on the rise (15% against 11% in 2004 and a mere 6.5% in 2003). Asia (6%) and intra-MEDA (5%) also growing; recipient countries in 2005: Turkey takes the lead due to large deals in the telecom field; Egypt – large projects in energy, banking and real estate Israel – remarkable number of technological investments; Syria, Algeria, Morocco (€2 to 3 bn each, but different profiles) ;Small countries (Tunisia, Jordan, Lebanon) perform relatively well

4.19 - Why is Europe concerned?

The Euro-Med challenge: an increasing divide!
The southern rim ('MEDA', 10 countries, 240 m pop.) needs to create 4 million jobs per year just to maintain its current unemployment rate. No jobs equal major risks
This challenge may be transformed into an opportunity:
A boost for local and regional development (40 million jobs mean 40 million consumers)
A new burst of growth for EU companies and societies looking for markets and growth
An obligation to develop reforms towards an investor-friendly environment
EU companies looking at MEDA as a growth destination
Eastern Europe and China are becoming less attractive (costs, capacity saturation etc.)
Big companies are better aware of the MEDA opportunities
MEDA is closing its gap vs. Eastern Europe (46% of projects in 2005, vs. 28% in 2002)

Example of *MedValley*
Potential innovation hubs at the very gates of Europe
Thousands of engineers & researchers; 100 clusters, technoparks, R&D centres detected by ANIMA in the South

A growing number of very large scale investments

4.20 - Top capital investments announced in 2005

1. Oger (Saudi Arabia), telecomm. network, Turkey, $6.55 bn
2. Vodafone (UK), telecomm. network, Turkey, $4.55 bn
3. Shell (Netherlands), energy, Turkey, $4.14 bn
4. Intel (United States), electronic components, Israel, $4 bn

5. Emaar Properties (UAE), real est./ public works, Egypt, $4 bn
6. Aref Investment (Kuwait), real est./ public works, Syria, $4 bn
7. Emaar Properties (UAE), real est./ public works, Syria, $3.9 bn
8. Telia Sonera (Sweden), telecomm. network, Turkey, $3.1 bn
9. Credit Line (Russia), energy, Syria, $2.7 bn
10. Apachi (United States), energy, Egypt, $2 bn

4.21 - Work in progress…

Legal integration of the Mediterranean markets (Standards, Customs): Via Euromed Market and Euromed Quality; Physical integration: Via Euromed Transport
Creation of a legal framework (e.g. IP rights): Via ANIMA Investment Charter, And other efforts - Doing Business (World Bank), OECD.
Networking and information sharing on potential markets and investors: SMILE and MIPO bases, UNIDO opportunities exchange, business forums, ANIMA web site.
Improvement of the Mediterranean image for investors. E.g. annual ANIMA business summit with The Economist –or this event…

4.22 - Preliminary Remarks:

The three pillars within the Euro-Mediterranean Partnership (also known as the „Barcelona Process"): Political and security partnership, Economic and financial partnership, Social, human and cultural partnership.
The main aim of the EMP is to promote economic growth. The main instrument for this is the creation of a Free Trade Area (FTA) by 2010.
The components of the EMP: The Euro-Mediterranean Association Agreements (EMAAs) aimed at liberalisation and cooperation in different areas;The financial support provided through MEDA and the European Investment Bank
How far the FTA will be reached depends on: Relative importancy of liberalization to other factors, Amount of liberalization achieved by the agreements.

4.23 - The aim of this overview: questions arising from figures.

Ten year after the beginning of the Barcelona process it is time to take stock. This is in part the aim of this seminar. Our overview has a narrower aim: to remind you some figures that can help to answer the following questions. Can we identify progress in the process of economic integration between Europe and Mediterranean partner countries? Can we detect some sign of positive impact resulting from the Barcelona process on the MPCs development? Above all, can we say that the role of Europe as economic partner of MPCs has been strengthened by the Barcelona process in comparison with the rest of the world? How attractive does Europe appear as a partner for MPCs in comparison to the rest of the world? The answers to the above questions are crucial in our view if the general objective of the Barcelona process, and of the announced (future) European Neighbourhood Policy, is to build a security belt around Europe through economic cooperation and integration.

4.24 - Extensive state interference in economy

Public sector employment accounts for 1/5 of non-military employment in MPCs
The contribution of the public sector on the GDP is significant (30% in Egypt and Tunisia, close to 60% in Algeria). Public investments in MPCs are close to 40% of total investment

4.25 - Why Such a Small FDI Share?

The region has long been plagued by violent conflict and instability

Several Mediterranean states have compounded this problem with poor economic governance; governments have monopolies in most strategic sectors – especially energy

Private sectors are generally small and largely dominated by family business groups

Poor social and physical infrastructures (eg. education and transport) diminish the attractiveness of the region. Electricity per capita, telecom and internet penetration rates are relatively poor; underdeveloped financial sectors (eg. central and private banking infrastructures) impede the mobilization and channelling of funds.

Strong local partners (eg. experienced local contracting firms) have been lacking, and there is a shortage of skilled labour; several of the region's administrations have lacked accountability and consistency (a feature of autocratic systems of governance).

There are still significant trade barriers in UE and MPCs

4.26 - Measures to improve FDI conditions specified under Barcelona Process

Withdrawal of the state so as to: improve resource allocation and competitiveness; increase budgetary resources; encourage national and foreign private investment

In-depth reform of indirect taxation, so as to reduce fiscal pressure on foreign trade

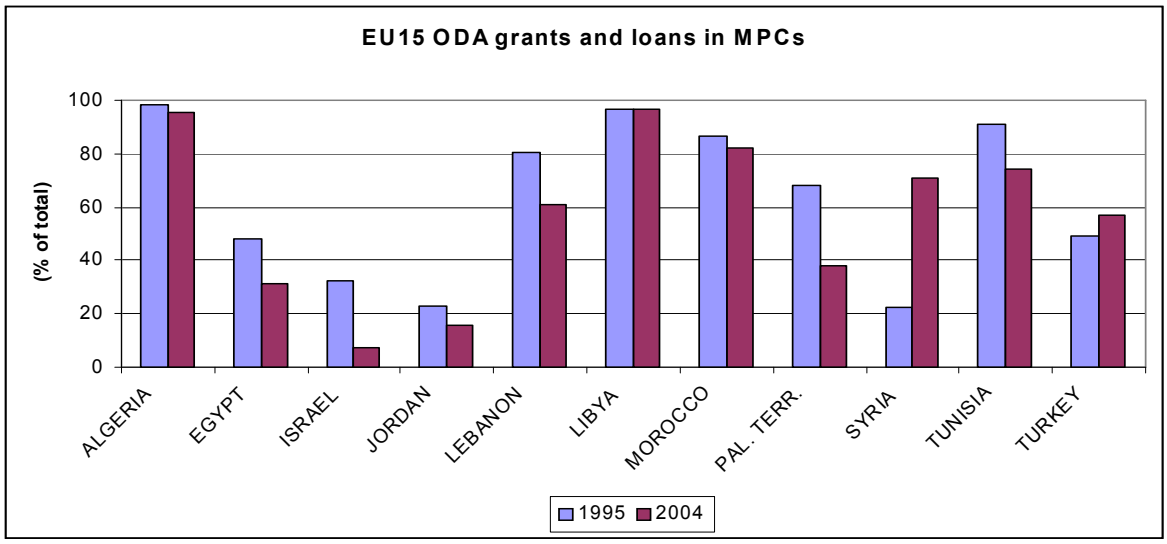
Opening up of financial intermediation activities to competition and scaling down public sector involvement in this field Support for privatisation in the Mediterranean region

MEDA I and II commitments and USAID economic assistance

	MEDA I e II Commitments				**USAID economic assistance**			
	1995-99 Millions euro	2000-04 Millions euro	1995-99 (% total bilateral)	2000-04 (% total bilateral)	1995-99 Millions USD	2000-04 Millions USD	1995-99 (% total)	2000-04 (% total)
ALGERIA	164	233	6	10	3	14	0	0
MOROCCO	656	678	25	29	85	136	1	1
TUNISIA	428	329	17	14	6	1	0	0
EGYPT	686	354	27	15	4307	3172	38	31
LEBANON	182	74	7	3	57	197	1	2
ISRAEL					5980	3659	53	36
JORDAN	254	204	10	9	511	2089	5	21
PALESTINIAN TERRITORIES	111	351	4	15	354	922	3	9
SYRIA	99	136	4	6		0	0	0
TOTAL BILATERAL	***2580***	***2359***	***100***	***100***	***11303***	***10191***		
TOTAL REGIONAL	480	739						
TOTAL	**3060**	**3098**			**11303**	**10191**	**100**	**100**

Source: European Commision, USAID Greenbook

Between 1995 and 2004, the EU15 share in total MPCs grants and loans has decreased from 53% to 45%.



4.27 - The Liberalisation Process

4.27 .1 - The Liberalisation of Agricultural trade

Key sector in most of the MPCs, for which the EU is the principal overseas market.

EU Agricultural trade policies are a complex system of seasonal preferences for *sensitive products* (e.g. tomatoes and oranges)

EU quantity and quality restrictions:

Tariff rate quotas (TRQs) on a large number of fresh fruit and vegetables and some dried or processed ones, as well as flowers, Tunisian olive oil and all qualities of wine;

Reference quantities (RQs) imposed on many fresh fruit and vegetables, some dried or processed ones, nuts, and fresh and preserved tropical fruit;

Sanitary and phyto-sanitary standards

MPC preferences are even more limited, both in terms of share of preferential over total trade flows and in term of tariff reductions for strategic products, like *cereals* and *milk,* that lead to high domestic prices; even if a liberalisation of agricultural trade would have enormous impact on Euro-Med trade flows, no defined prospect for the liberalisation of agriculture was stressed under the Barcelona Process; there have been no significant new concessions made by the EU for agriculture products in the EMAAs, nor are these expected to come about in the near future.

4.27. 2 - The liberalisation of Industrial products trade

The EMAAs set out a trade liberalisation commitment by the MPCs, which complements the tariff-free treatment for industrial goods already granted to their exports to the EU since mid-1970s; Under the EMAAs the MPCs gradually remove all tariffs on imports of industrial products from EU over by 2010.

The specific time schedules for dismantling are differentiated according to the sensitivity of the goods.

Tunisia is ahead of other MPCs in reforming ist economy and implementing a range of major reforms, except for abolishing trade barriers. If the liberalisation of manufactured goods was implemented overnight, 1/3 of the industrial firms would go bankrupt.

With a view to achieving a full FTA, the MPCs are also expected to implement free trade among themselves (South-South integration)

4.27.3 - The liberalisation of textiles and clothes trade

The countries in the Southern and Eastern Mediterranean area employ over 3.7 million people in the textile sector: 39% of total employment in Morocco, 41% in Tunisia, 34% in Turkey.
The share of T&C exports of their total exports to the EU is high (e.g. 54% for Tunisia, 53% for Morocco, 47% for Turkey)
The importance of this sector is double:
Because of the very important dependance of MPCs on the Eu market for their exports and employment;
Because of the close relationship between EU T&C industry and the T&C industry of those countries, via investment and subcontracting relationships
In 2004, the EU imports from MPC represent 28% of EU textile market (12,8 billion €) and EU exports to MPC represent 14% of EU textile market (2,3 billion €)
Due to WTO, the Agreement on textiles and clothing expired on 2005
Between January and May 2004, the EU imports from China represent 11% of EU textile market. One year late, the EU imports from China represent 22% of EU textile market

4.28- 3 The liberalisation of trade in Services

The liberalisation of trade in services: will spill over into the production and export of goods; will serve to improve the functioning e.g., transport, energy, telecoms, finance in the MPCs;
Regional solutions to promote liberalisation of trade in services:
Reform of the transport sector at national level, definition and promotion of an efficient regional transport infrastructure network, with national transport systems linked to each other and with Trans-European Networks; development of appropriate energy policies
Modernisation of the telecomunications sector and facilitation of interconnections as a prerequisite for the development of the Information Society.

In the context of the EU's relationship with its Mediterranean partners, **rules of origin** (ROOs) are increasingly seen as playing an important role; in principle the Mediterranean partners should adopt what is known as the "pan-European system of cumulation of rules of origin", rules of origin can indeed serve to restrict suppliers' ability to buy their inputs from the cheapest available source. In so doing rules of origin impact upon patterns of trade, production and consequently also welfare. Clearly to the extent that rules of origin do indeed have such an impact, this is likely to fall most heavily on small, possibly less diversified economies, who consequently find it more difficult to source their inputs domestically and competitively.

4.29- Conclusion

The European Commission has reached a critical level in order to have a significant impact on national policies only in some Mediterranean Partner Countries; the total MEDA I and II commitments for the period 1995 -2004 have been less than one third of the USAID economic assistance for the same period (even if this assistance has been concentrated in three countries: Israel, Egypt and Jordan).the EU15 (European Commission and member states) share in total MPCs grants and loans has decreased from 53 % to 45 %.; the MPCs are not following the global trend towards trade liberalisation and this implies that these countries are losing in terms of international competitiveness relative to other regions in the world; this creates a cumulative process: high protection rates increase the relative strength of import-substitution inefficient industries and in this way the strength of lobbies in favour

of maintaining high protection rates increases as well; the mechanism is made possible in presence of inflows of foreign exchange coming from remittances, export of natural resources, financial official assistance (grants and loans) and FDI; a role in maintaining the mechanism was the preferential access to European markets that some MPCs countries enjoyed for some products (for example textiles and clothes).
Currently, the liberalisation of textiles and clothes imports from Asia dramatically changes the context in which MPCs have to compete in European markets and the expected returns of investments made in these sectors; some final considerations within the framework above described: Trade liberalisation needed for attracting more FDI and increase competitiveness of the MPCs production creates major problems for government tariff revenues and for the social impact of the structural adjustment process in both import-substitution industries and export-oriented industries.Which are the financial resources and the size of unilateral trade liberalization that EU is willing to offer to MPCs for alleviating their structural adjustment? The increasing trade with the US suggests that their trade agreements and financial support are more effective than the European initiatives. In fact, when the prime objective is political as well as related to creating development, the quantity of assistance, both in terms of absolute value and in proportion to the offer by other donors, becomes an important factor in the effectiveness of the policy itself. This is the case particularly when other countries offer assistance, having objectives not always consistent with or in conflict with European ones.In conclusion what does the EU currently offer to MPCs in order to carry on the Barcelona process?

The Barcelona Process has increased the potential for trade between EU and Mediterranean Countries mainly by a gradual liberalisation of industrial goods imports in the Mediterranean countries, thereby complementing the unilateral opening of EU markets at the end of the 1970s; However, the trade potential for agricultural products and services is still underexploited. The intra-Mediterranean trade potential is even more restricted because regional trade liberalisation has hardly begun. However, most Mediterranean countries are at least WTO and GAFTA members. Furthermore, trade liberalisation needs to be accompanied by measures which enable the private sector to compete internationally and to exploit its trade potential; since the beginning of the Barcelona Process some countries' trade with the EU developed more dynamically than others', something which is clearly linked to their appetite for reforms. In general, partner countries which committed themselves early to trade liberalisation and accompanying economic reforms under the terms of the Association Agreements also experienced a better trade performance with the EU than their peers. In this respect, Association Agreements helped to anchor domestic economic reforms and liberalisation.

The Barcelona Declaration emphasises the importance of a favourable business climate for domestic investment and for foreign direct investment. The EU supports the reform process in the Mediterranean countries with technical and financial aid. Furthermore, FDI is generally positively correlated to commerce. Therefore, the trade liberalisation stimulated by the Barcelona Process should also foster FDI flows into the Mediterranean countries. It should not come as a surprise that those countries which have signalled a particular willingness to undertake economic reforms by adopting the Association Agreements at an early stage have attracted more FDI in relation to their GDP than their peers.
The future economic integration and growth in the Euro-Mediterranean area will depend on the further liberalisation of goods and services trade, and on efforts to attract more investment, both of which will be guided by the European Neighbourhood Policy. However, without an assertive economic reform drive on the part of the Mediterranean partners to

overcome the unsatisfactory level of the region's development, concerted Euro-Mediterranean efforts to improve the economic development may not be sufficient.

Basic agreements between the EU and MPC

	Association Agreement	Cooperation Agreement	Euro-Mediterranean Association Agreement			ENP Action Plan
	into force		signed	trade provisions into force earlier	into force	
Algeria		1 November 1978	22 April 2002	-	1 Sept. 2005	-
Egypt		1 November 1978	25 June 2001	1 January 2004	1 June 2004	-
Israel		1975	20 November 1995	1 January 1996	1 June 2000	x
Jordan		1 November 1978	24 November 1997	-	1 May 2002	x
Lebanon		1 November 1978	17 June 2002	1 February 2003	1 March 2003[a]	-
Morocco		1 November 1978	26 February 1996	-	1 March 2000	x
Palestinian Authority		-	24 February 1997	-	1 July 1997[b]	x
Syria		1 November 1978	initialled Oct. 2004	-	-	-
Tunisia		1 November 1978	17 July 1995	-	1 March 1998[c]	x
Cyprus[d]	1 June 1973					
Malta[d]	1 April 1971					
Turkey[e]	1 December 1964					

Source: European Commission.

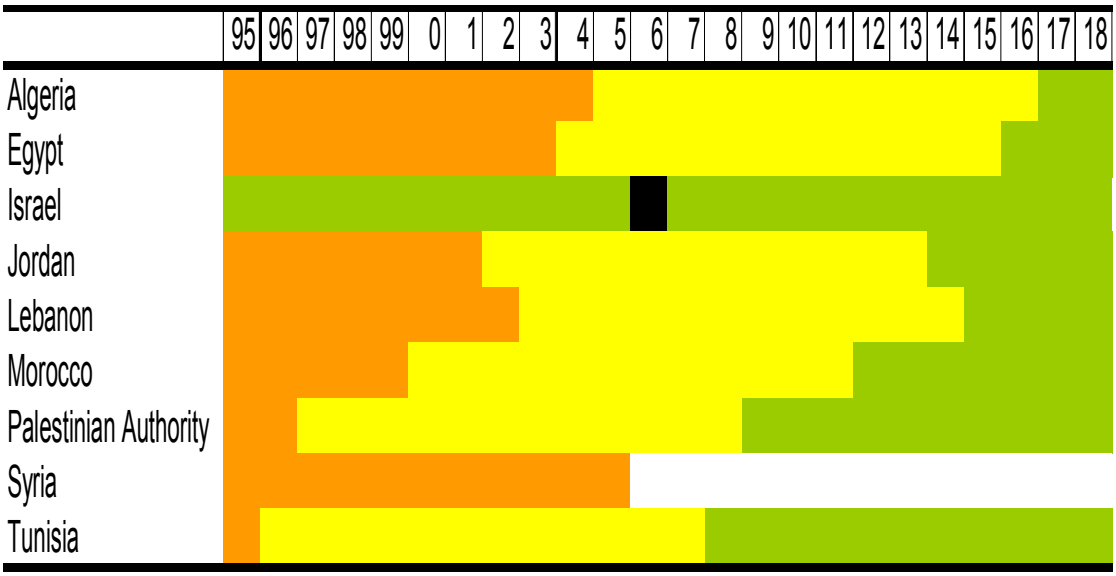
[a] Interim Agreement.

[b] Interim Agreement not recognised by Israel.

[c] Tunisia has unilaterally anticipated the implementation for industrial products from 1 January 1996.

[d] A customs union was one of the long-term objectives of the Association Agreement but did not enter into force before the country became an EU Member State on 1 May 2004.

[e] A customs union between the EU and Turkey entered into force on 1 January 1996. Turkey is a recognised candidate for EU Membership since 1999.



Source: Data from European Commission.

Notes: red - no Association Agreement (AA), yellow - gradual liberalisation, green - full liberalisation.

Mediterranean regional trade agreements (extra EU)

	WTO joined	GAFTA signed[b]	AGADIR FTA signed	Pan Euro MED RoO	US MEFTA into force[c]	bilateral with
1 Algeria	observer	2002	-		-	
2 Egypt[a]	1995	1998	2004	2006	-	12
3 Israel	1995	-	-	2006	1985	4
4 Jordan	2000	1998	2004		2001	3
5 Lebanon	observer	1998	-		-	
6 Morocco	1995	1998	2004	2006	2006	12
7 Palestinian Authority	-		-		-	
8 Syria	-	1998	-		-	12
9 Tunisia	1995	1998	2004		-	12
10 Cyprus	1995	-	-		-	
11 Malta	1995	-	-		-	
12 Turkey	1995	-	-		-	2,6,8,9

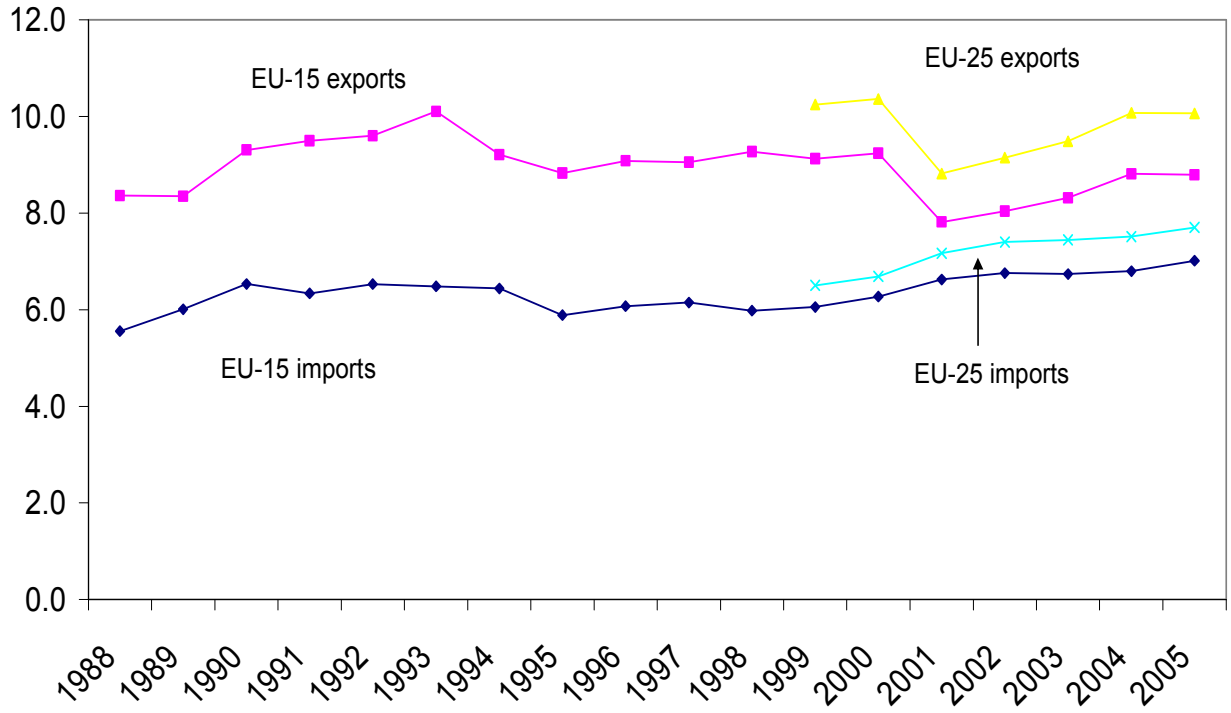
Sources: European Commission, White House, World Bank, WTO.

[a] Since 1998 Egypt is also a member of the Common Market for Eastern and Southern Africa (COMESA).

[b] Greater Arab Free Trade Area. Other members: Bahrein, Iraq, Kuweit, Libya, Oman, Saudi Arabia, Sudan, Qatar, UAE, Yemen. Except ALG GAFTA became effective on 1 January 2005 with a transitional system of rules of origin demanding a 40% ratio of Arab content.

[c] US-Mediterranean Free Trade Area suggested by President Bush in 2003.

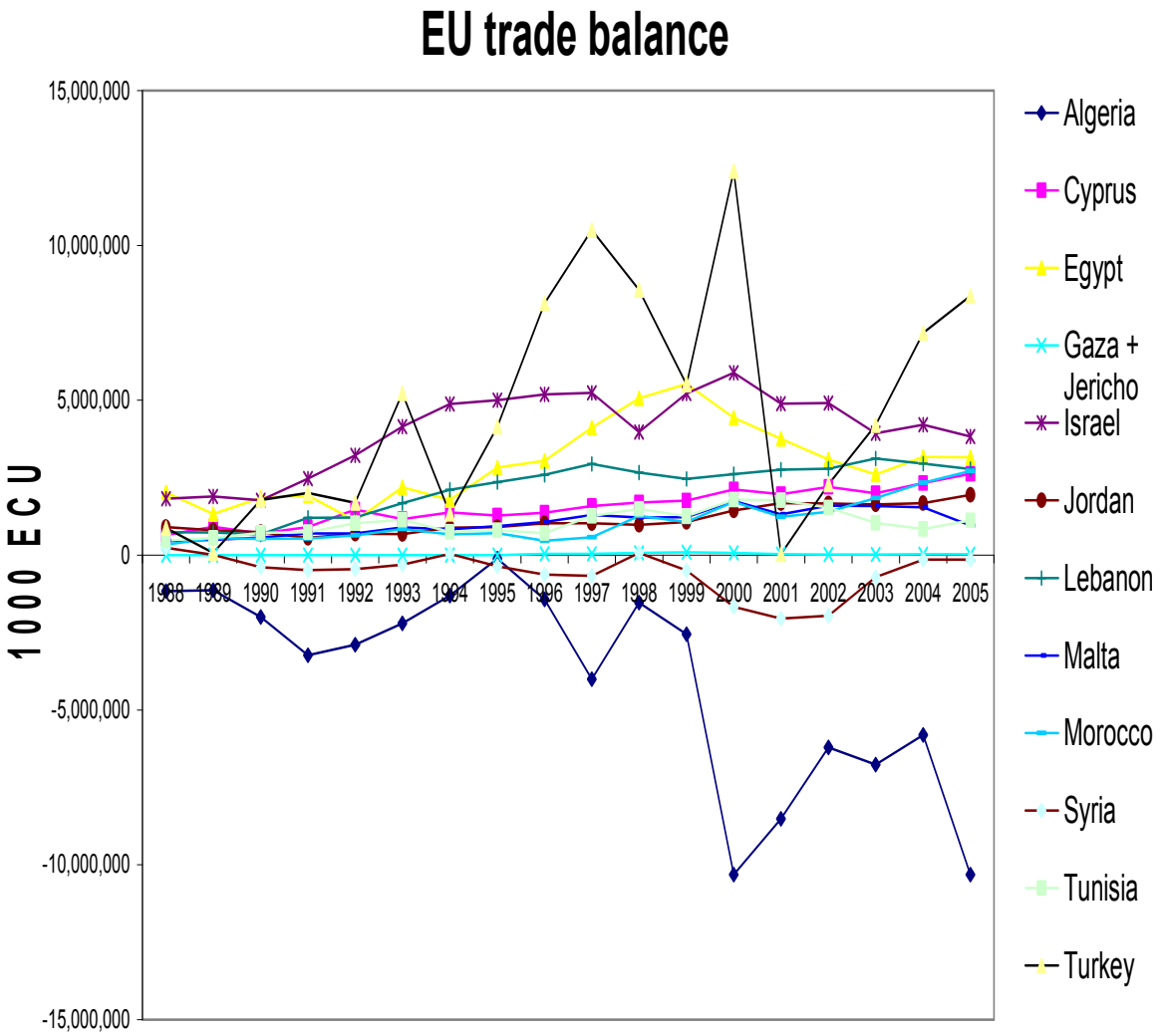
MED share in extra-EU trade of goods (%)



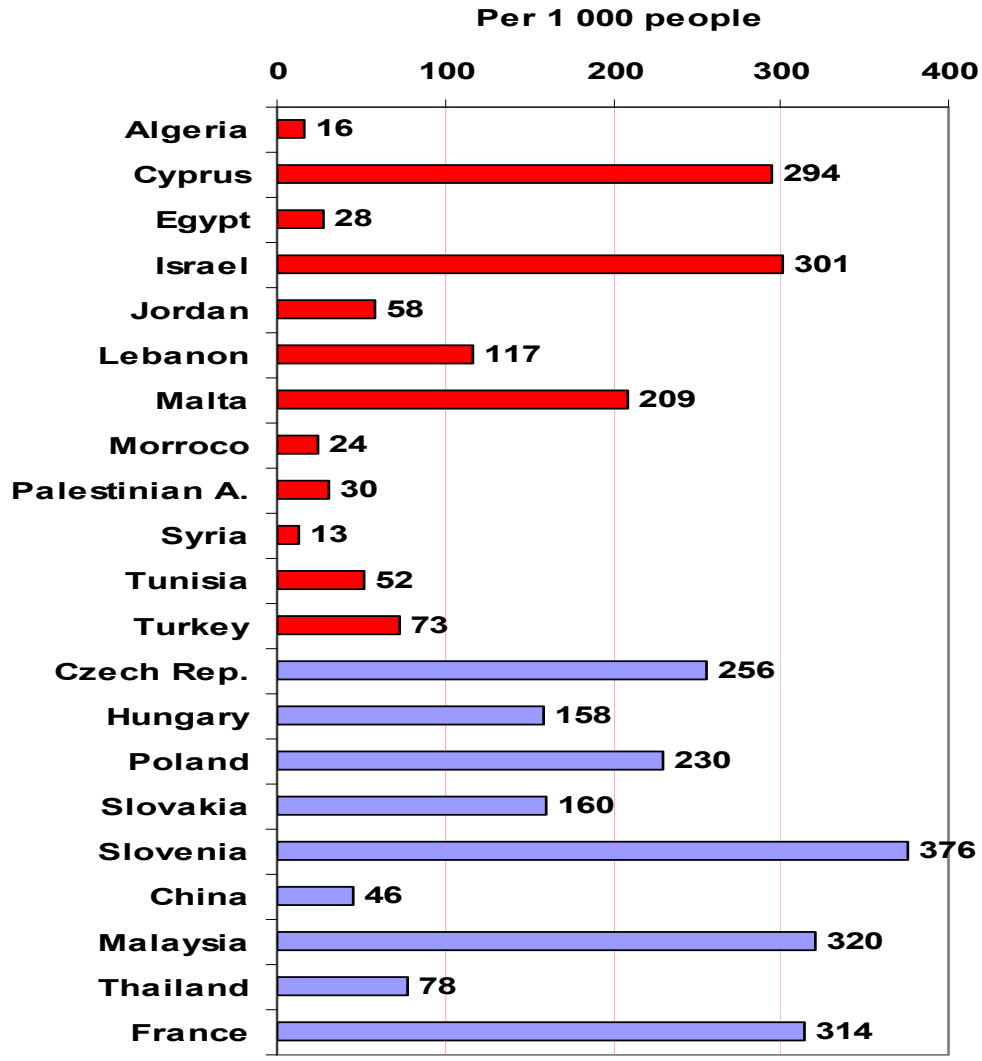
Source: Eurostat

The main Investors in MENA

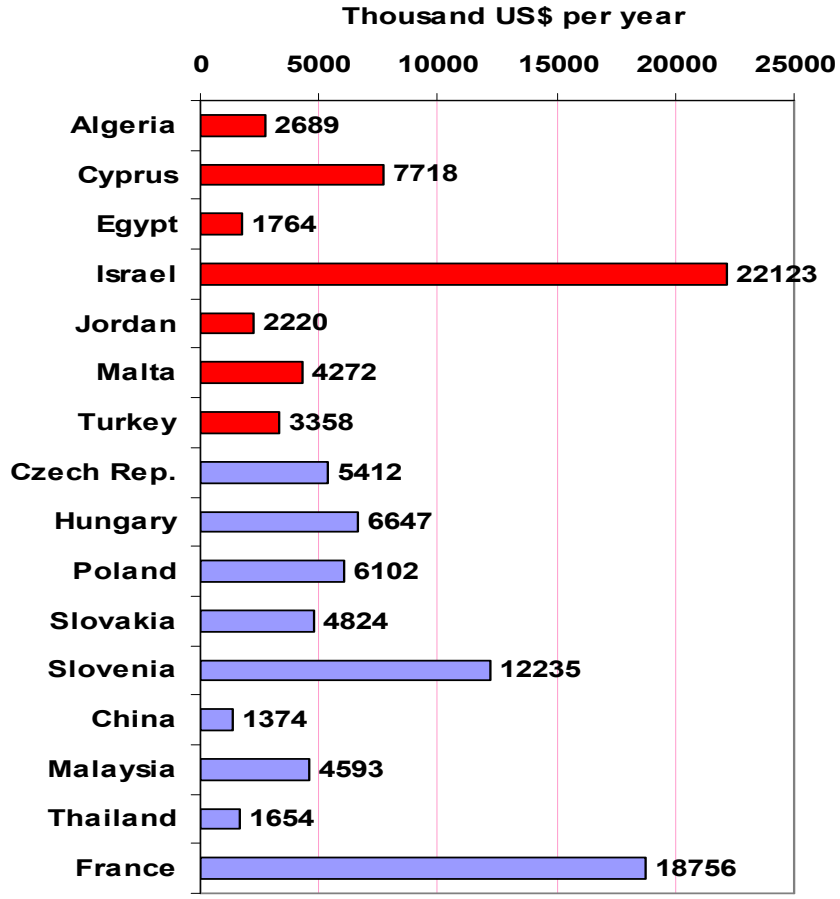
- Accor (8 projects)
- Alcatel (2 projects)
- Alcoa
- Alstom
- Altadis (2 projects)
- Arcelor (2 projects)
- AstraZeneca
- Auchan
- Banque Populaire
- Barilla
- BAT
- Bayer
- Benetton (2 projects)
- BHP Billiton
- BMW
- BNP-Paribas (3 projects)
- Bosch (2 projects)
- Bouygues
- British Airways
- British Gas (4 projects)
- BP
- Bulgari
- Caixa
- Calgary Centurion
- Canon
- Carrefour (2 projects)
- Cartier
- Castel (3 projects)
- China National Petroleum Corporation (4 projects)
- CIC
- Ciments Français
- Cimpor (2 projects)
- Cisco Systems (3 projects)
- Club Méditerranée
- CMA-CGM
- Compass
- Computer Associates (2 projects)
- Cosmopolitan
- Daewoo
- Deutsche Bank
- DHL (2 projects)
- Dior
- El Watania
- Euler & Hermès
- FADESA
- Fagor
- Fiat
- Ford
- Four Seasons
- Fram (2 projects)
- Gazprom
- Gemplus
- General Electric
- Geopost
- GlaxoSmithKline
- Haribo
- Henkel
- Hewlett Packard (3 projects)
- Honda
- Hugo Boss
- IBM (3 projects)
- IFC
- Ikea
- Inditex (Zara)
- Intel (3 projects)
- Intercontinental
- Jaako Poyry
- Juniper Networks
- Kraft Foods
- Lafarge (5 projects)
- Land Rover
- Legrand
- Leroy Merlin
- Lucien Barrière
- Lufthansa
- Maersk
- Majid Al Futtaim (3 projects)
- Man
- Marriot
- Matra
- Mercedes
- Merloni TermoSanitari
- Metro
- Michelin
- Moody's
- Morgan Stanley
- Motorola
- Nestle
- Nexans (2 projects)
- Nissan Motor
- Nokia
- Novartis
- Novell
- Oracle
- Orascom (6 projects)
- Petronas
- Philip Morris
- Procter & Gamble
- Radisson
- Regus
- Renault (5 projects)
- Repsol (2 projects)
- Roche
- SAB-Miller (2 projects)
- Sagem
- Samsung (2 projects)
- Sanofi-Synthelabo
- Scancom (2 projects)
- Scania
- Shell (2 projects)
- Siemens
- SNC Lavalin
- SNCF
- Snecma
- Société Générale
- Speedy
- ST Micro Elect. (3 projects)
- Starbucks
- Statoil
- Suez
- Sun Microsyst.
- Tesco (2 projects)
- Thales
- Total
- TUI
- UPS
- Veolia
- Vivendi
- Vodafone



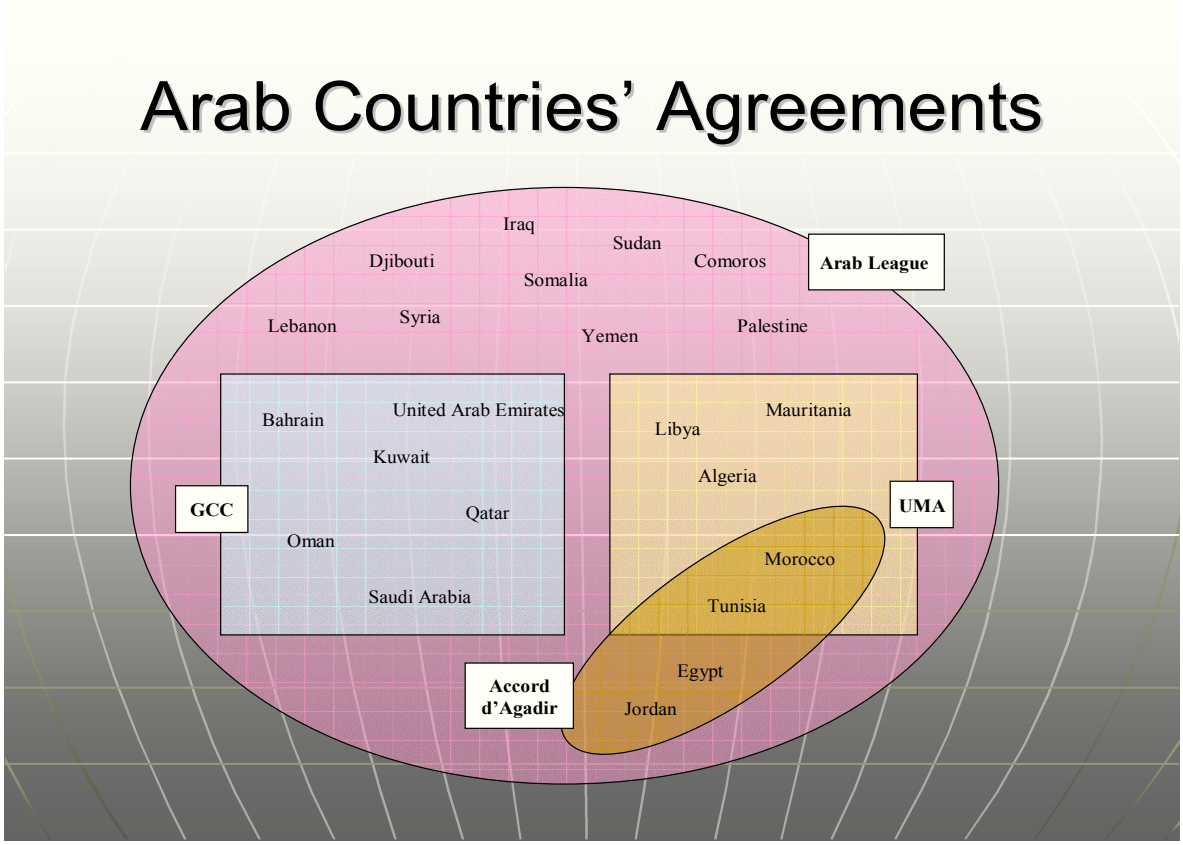
Source: Eurostat, COMEXT



internet user 2005



industrial annual wages 99-2004



The Arab World Preferential Trade Agreement

The legal and regulatory framework of FDI in the Mediterranean region

Table 1 - Legislative measures supporting FDI		
Country	*Legislative provisions*	*Year*
Algeria	Investment Code – Law 12/1993	October 1993
Cyprus	February 1997	1997
Egypt	Law n. 230/89 Foreign Investment Law n. 8/1997 Investment Incentives and Guarantees Law	1989, 1997
Israel	Law n. 579/1959 - Encouragement of Capital Investment Law (ECIL) Law 5750/1990 – Law for the Encouragement of Investment (Capital Intensive Companies)	1959,1990,
Jordan	Law n. 16/1995 – Investment Promotion Law	1995, 1996
Lebanon	No specific law	
Malta	No specific law	
Morocco	Law n. 18/1995 – Investment Chart	1983, 1995
Palestinian NA		1995
Syria	Law n. 10/1991 – Law of Investment	1991
Tunisia	Law n.120/1993 - Investment Incentives Code	1993
Turkey	Law 6224/1954 (promotion of FDI) Law 6411/1994 (State assistance to FDI) Decree n 6990/1995	1954,1994, 1995

Table 2 Environmental conditions					
Country	*Aims*	*Quantitative limitations*	*Legal form of companies*	*Excluded sectors*	*Treatment of foreign enterprises*
Algeria	Yes	None	N.a.	None	National treatment
Cyprus	No	Yes (49% for agriculture and hotels)	N.a.	Yes (real estate, education, travel agencies, telecom, postal services)	Resident/non resident distinction
Egypt	Yes	No, Free zones Yes (10% in banking)	All	Yes (agricultural land)	National treatment
Israel	No	Yes in privatised sectors	All	Defence industry	National treatment
Jordan	No	No, abolished in 1997 (25% in publishing sector)	N.a.	Listed sectors with limited foreign ownership	National treatment
Lebanon	No	Yes (real estate) No, others	All	Yes (weapons, national security)	National treatment
Malta	No	None	All	State monopoly	National treatment
Morocco	Yes	No, abolished in 1988	All	Strategic sectors (agriculture, phosphate extraction)	National treatment
Palestinian NA	Yes	None	All	None, but with approval in some sectors	National treatment
Syria	Yes	No, but with minimum amount of investment	All	Yes (positive list)	National treatment
Tunisia	Yes	No Yes (49% in services on shore)	All	None, but some sectors do not receive incentives	National treatment (with the exception of agriculture)
Turkey	Yes	No, but with minimum amount of investment	All	Yes (financial services, oil)	National treatment (with the exception of the pre investment phase)

Table 3 Summary of liberalisation and environmental conditions		
Country	*Strong liberalisation*	*Low liberalisation*
Algeria	X	
Cyprus		X
Egypt		X
Jordan	X	
Israel	X	
Lebanon	X	
Malta	X	
Morocco	X	
Palestinian Territories	X	
Syria		X
Tunisia	X	
Turkey		X

Table 4 Conditions of activity of foreign enterprises						
Country	*100% land ownership*	*Intellectual property Rights*	*Composition of controversies*	*Free Zones*	*Multilateral Agreements*	*Bilateral Agreements*
Algeria	Yes, excluding oil and gas fields	Trademarks – Law 33/1952 Patent – Law 22/1953 Copyright Law 22/1992	Yes	1	WIPO (1985) Stockholm Act (1967) Paris Convention	BIT 4 + 7 under negotiation D.I. 4+5 under negotiation
Cyprus	Yes, with guarantee in case of expropriation	Copyright 1994 Patent 1998	Yes	2	WIPO (1984); WTO (1995) Trademark Law Treaty (1999) Paris Convention	BIT 10+23 under negotiation D.I: 26
Egypt	Yes, excluding oil and gas fields	Patent 1949 Software 1994	Yes	8	WIPO (1975); WTO (1995) Trademark Law Treaty (1999) Paris Convention	BIT N.a. D.I. 29
Jordan	Yes, with guarantee in case of expropriation	Copyright '98 Trademark and Patents (7 years protection)	Yes	3	WIPO (1972)	BIT N.a. D.I. N.a.
Israel	Yes, with guarantee in case of expropriation	Patent 1967 (20 years protection) Trademark 1972 (7+14 years protection)	Yes	No	WIPO (1970);WTO (1995))	BIT 10 D.I. 30.
Lebanon	Yes	Law 2385/1924 under revision	Yes	2 plus 7 planned	WIPO (1986) Paris convention	BIT 29 D.I. 21
Malta	Yes, with guarantee in case of expropriation	Yes	No	1	WIPO (1977); WTO (1995) Paris Convention	BIT 7 D.I. 24
Morocco	Yes	Yes	N.a.	4	WIPO (1971) WTO (1995) Madrid Protocol (1989) Paris Convention	BIT 23 D.I. 22
Palestinian NA	Yes, with guarantee in case of expropriation	Trademarks 1954 Patent 1953	Yes	No	None	BIT n.a. D.I. n.a.
Syria	Yes	Patent e trademark	If considered in the contract	6	Paris Convention	BIT 4 D.I. 4
Tunisia	Yes, with authorisation, excl. agricultural land	Yes	Yes	2	WPO (1975) WTO (1995) Paris Convention	BIT n.a. D.I. 27
Turkey	Yes	N.a.	Yes	10	WIPO (1976); WTO (1995) Madrid Protocol Paris Convention	BIT 24 D.I. 39

Note: WTO membership implies since 1st January 2000 the adoption of the provision of the TRIPS Agreements

Table 5 **Summary on property right protection**		
Country	*High protection*	*Low protection*
Algeria		X
Cyprus	X	
Egypt	X	
Jordan		X
Israel	X	
Lebanon	X	
Malta	X	
Morocco	X	
Palestinian NA		X
Syria		X
Tunisia	X	
Turkey	X	

Table 6 Red Tapes and limitation to the activity of foreign enterprises											
Country	*Authorisation to establishment*			*Labour*		*Rights of workers*		*Other restrictions*		*Environment protection*	
	Authorization	*Authorizing agency*	*Promotion Agency*	*Limitations on domestic workers*	*Limitations on foreign workers*	*Ad hoc law*	*Trade union*	*Restriction on imported material*	*Performance requirement*	*Ad hoc law*	*Membership to international agreements*
Algeria	Yes, in case of incentives	APSSI	APSSI	None	None	Yes, 1990	Yes with approval	No	No	N.a.	N.a.
Cyprus	Yes	Ministry of Trade	No	None	None	Yes	Yes	No	No	N.a.	N.a.
Egypt	No, in priority sectors Yes, in defence industry, tobacco, Sinai	GAFI	No	None	N.a.	Yes, 1981	Yes	No	No	Yes	N.a.
Israel	No Yes, for fiscal incentives	Yes	No	None	None	Yes, 1958; 1968; 1988	Yes	No	No, excl. public contracts	N.a.	N.a.
Jordan	Yes	Yes	IPC High Council for the Investment Promotion	None	Yes	Yes, 1996	Yes	Yes, over 2000 D	No	N.a.	N.a.
Lebanon	No	No	IDAL	None	Preliminary authorisation	Yes	Yes	No	No	N.a.	N.a.
Malta	Yes	MDC	MDC	None	None	Yes	Yes	No	No	N.a.	N.a.
Morocco	No Yes, for fiscal incentives (automatic if no answer after 60 days)	No	ODI IPF IWAA	None	None	Yes	Yes	No	Those defined as objective	N.a.	N.a.
Palestinian NA	Yes	Minister	PCPI	N.a.	N.a.	N.a.	Yes	No	No	N.a.	N.a.
Syria	Yes	HCI	No	Yes	N.a.	Yes	Yes, with limitations	Yes	Yes	N.a.	N.a.
Tunisia	Yes, in specific sectors with ownership higher than 50%	No	FIPA	None	Yes	Yes	Yes	Yes	Yes, in some sectors	Yes	ANPE
Turkey	Yes, with the exception of the pre investment phase	GDFI	GDFI	None	Yes	Yes, 1971	Yes	No	Yes	N.a.	N.a.

	High deregulation	Low deregulation	High liberalisation	Low liberalisation
Algeria		X	X	
Cyprus		X	X	
Egypt		X	X	
Jordan		X		X
Israel	X		X	
Lebanon	X			X
Malta		X	X	
Morocco	X		X	
Palestinian NA	X		N.A.	N.A.
Syria		X		X
Tunisia	X			X
Turkey		X		X

Table 8 - Profitability and incentives										
	Transfer of profit and capital			Tax regimes					Fiscal and Financial Incentives	
Country	Transfer of profits	Transfer of capital (shares)	Repatriation of capital	Import duties	VAT or consumption taxes	Income taxes	Corporate taxes	Social security on enterprises	Fiscal incentives	Financial incentives
Algeria	Yes	Yes	Yes	From 5% to 45%	13%	From 12% to 70%	42%	29%	Yes	None
Cyprus	Yes, in the country of origin	Yes	Yes	Several rtes	8%	40%	25%	6,3%	Yes	None
Egypt	Yes	Yes	Yes	n.a.	From 5% to 30%	From 20% to 32%	From 32% to 42%	26%	Yes	None
Jordan	Yes	Yes	Yes	Up to 45%	10%	From 5% to 30%	From 15% to 35%	8%	Yes	None
Israel	Yes	Yes	Yes	From 2% to 10%	17%	From 10% to 50%	36%	From 0,70% to 4,93	Yes	Yes. Financial contribution from 5% to 38% of the invested capital according to the location of investment
Lebanon	Yes	Yes	Yes	15%	n.a.	From 3% to 10%	10%	From 8.5% to 15%	Yes	None
Malta	Yes, automatic authorisation	Yes	Yes, after authorisation	15% (from EU); 23% (from non-EU)	15%	From 10% to 35%	35%	10%	Yes	None
Morocco	Yes	Yes	Yes	From 2,5% to 10%	From 7% to 14%	From 14% to 46%	38,5%	6,52%	Yes	Yes. Special financial incentives for larger investments
Palestinian NA	Yes	Yes	Yes	Several rates	17%	From 5% to 48%	38,5%	N.a.	Yes	None
Syria	Yes	Yes, after 5 years	Yes	From 1% to 100%	Up to 20%	Up to 12,5%	From 32% to 42%	From 5% to 18%	Yes	None
Tunisia	Yes	Yes	Yes	From 10% to 287%	From 6% to 29%	35%	35%	16%	Yes	Yes. Financial contribution from 5% to 38% of the invested capital according to the specific sectors
Turkey	Yes	Yes	Yes	Several rates (generally low)	From 8% to 23%	From 25% to 55%	49,22%	19,5%	Yes	None

Table 9 - Summary of profitability and incentives						
	Transfer of profits and capital		Taxation		Incentives	
Country	High liberalisation	Low liberalisation	Normal fiscal pressure	Low fiscal pressure	Non discriminatory	Discriminatory
Algeria	X		X		X	
Cyprus		X		X	X	
Egypt	X		X		X	
Jordan	X		X		X	
Israel	X		X			X
Lebanon	X			X	X	
Malta		X	X		X	
Morocco	X		X			X
Palestinian NA	X		X		X	
Syria		X	X		X	
Tunisia	X		X			X
Turkey	X		X		X	

4.30 - Textile and clothing sector

The textile and clothing sector plays a key role both in the Mediterranean economies and in trade between the latter and the European Union. The leading industrial sector in Turkey or in Tunisia, it represents overall 50% of manufacturing exports from the MEDA region towards the EU. Conversely, the MEDA countries represent important outlets for the European textile industry, whose products are transformed south of the Mediterranean later to be re-exported in the form of garments, towards the West European market.
An important Complementarity has thus been created in the sector between the two shores of the Mediterranean.
However, this Complementarity is currently threatened by two concomitant movements: On the one hand, the rise in power of the clothing industries of Eastern Europe, towards which investment flows and subcontracting contracts from Western Europe are increasingly directed; on the other hand, competition from Asian industries, especially the Chinese, which is likely to continue to grow in years to come as a result of the phasing out of the Multi Fibre Arrangement from the 2005, following the signing of the Textile and Clothing Agreement (ATC) in Marrakech in 1995. From 2005 until now, all the quantitative restrictions on the trade of textile and clothing products should be lifted.
Faced with the double-edged challenge of increased competition on the European market as well as on their domestic markets, the Mediterranean textile industries must modernize.

As for the European textile and clothing sector, it has been particularly hard hit by the industrial relocation movements which have taken place over the past 20 years to the benefit of the Eastern and Southern peripheral areas of the continent. Representing an opportunity for those countries with low labor costs, (for example, Romania), this movement is symmetrically perceived as an industrial desertification factor for those countries with high internal costs (for example, France), and presents a problem of reconversion for those countries with intermediate features which had initially based their industrial take-off on labour intensive activities and which have witnessed their labour costs rise in line with the development process as it has taken shape (for example, Tunisia).

It is therefore interesting to study this activity in a systemic perspective which both throws light on the sets of problems which affect a developed country such as France and those of countries situated at different stages of the industrialization process such as those of the MEDA region and the countries of Eastern Europe.

This is what we can observe which links the two points of view, to subsequently examine the extent to which coordinated industrial policies are possible or desirable.

An analysis of the sector brings to light, however, the marked specificities of the industrial segments upstream (textile) and downstream (garments-clothing), who's very different technique-economic features therefore involve, for the companies concerned, very distinct location behavior and geographical configurations.

It is for this reason that the textile industry, more capital intensive, with a more concentrated industrial offer, will locate more willingly in areas offering a highly structured industrial environment and qualified labour resources.

The garment industry, on the other hand, represents an activity with relatively low investment costs (at least for the make-up/assembly phase), relatively little concentrated and highly sensitive, at least for mass production, to unqualified labour costs.
Without altogether eliminating the problem set of textiles, the present study focuses essentially on the garment manufacturing sector.

In the first part, the analysis concern's the industry structures and the overall trends currently in force on the European market concerning the supply, the demand, and the important technological evolutions. In the second part, an examination will be made of the evolution underway in the geography of the activities within the Euro-Mediterranean area and their consequences for the different groups of countries concerned: Western Europe, first and second generation Eastern Europe, countries from the MEDA region etc.

In conclusion, certain proposals of action specific to the countries of the MEDA region are made.

4.31 - Organization and evolution of the textile sector
4.32 - Presentation and definition of the sector
4.33 - A sectoral approach

The textile and clothing sector is composed of two very distinct industries:
On the one hand, upstream, the textile industry, which produces the fabrics with the following stages: preparation of the raw materials, spinning, weaving or knitting, treatment; on the other hand, downstream, the garment and clothing industry which covers the manufacture of an article of clothing, furnishing and textiles for technical uses.
Well upstream are to be found the raw material suppliers (natural, artificial and synthetic fibres), and further downstream, the distributors.
The clothing field itself comprises the following stages: research and development (design offices, trends, and prototypes), layout and grading, cutting; make-up, finishing. It is often assimilated to the garment industry. However, it should be noted that the production of the garment sector (and a fortiori the textile sector) is not entirely intended for the clothing sector, as part of it is used by other ~ industries: manufacture of household linen, furniture manufacturing, wall coverings, technical uses

Main features of the activity in the Euro-Mediterranean region
In 2001, the textile and clothing sector in the Euro-Mediterranean region represented a production of around 250 billion Euros including 200 for Europe. It employed 7 million workers, including 2 million in Western Europe, 1 million in the C.hEC countries and 4 million in the MEDA countries.

The total market represented 272 billion Euros, including 227 for Western Europe, 32 for the MEDA region and 13 for the CEEC countries. Western Europe in more specialised in the upstream part, the CEEC countries and the MEDA region in the downstream operations. As a matter of facts, textiles represent 65% of European production in the sector against only 35% for the garment industry compared with respectively 55% and 45% for the remainder of the Euro-Mediterranean region.

The sector represents, for certain countries of the MEDA and CEEC regions, a major economic stake. It is, for example, the leading industrial sector and the top export segment for Tunisia, Turkey, Morocco and Romania.

In Western Europe, in 2001, there were more than 110,000 enterprises in the sector, employing 2 million people an41 with a turnover of nearly 200 billion Euros, 70 billion of which for the garment segment.
However, these industries, subjected to *very* strong relocation movements, are on the decline, at least in employment terms. For example, the French clothing industry lost more than 63% of its jobs, between 1986 and 2001, which are more than 100,000 jobs. On the other hand, the turnover remained more or less stable.

4.34 - The market and the demand

The European market represents by far the main export outlet for the clothing industries of the MEDA region countries.

4.35 - The size of the market

Clothing represents the second most important budget item for European households, for a total market estimated at around 230 billion Euros (for the whole sector). However, the share of clothing in total household expenditure in Europe is tending to decline: 4% in 2000 against 5.9% in 1980. Getaway, France, the United Kingdom and Italy alone represent more than 70% of the West European market

Women spend the most: in the ready-to-wear segment, they represent 54% of sales in percentage of turnover, while men only represent 34%. The remainder of the market concerns children.

The demographic factors (volume and population growth rate) influence the consumption of garments. Today, the share of the under-25 year olds is increasingly important in annual clothes expenses. On the other hand, the share of older people is much less.
The share of clothes expenses grows in relation to the level of income, as is shown by the analysis by socio-professional category.

4.36 - Market segmentation

The European clothing market may be divided into four segments: the top-of-the-range, the classic, the fashion and the basic, each with its own features: higher added value per capita, investment rate and publicity effort particularly for the top of the range.

4.37 - The quantitative evolution of the market

Slow growth in the demand for clothes products may be observed in developed countries. The low demographic dynamism, the drop in comparative prices, the relative saturation of basic needs explain a continual decline in the share of the expenses of clothes in household budgets, a movement which should continue in the medium term. There is more rapid growth in demand in the CEEC and MEDA countries, for the opposite reasons: higher demographic dynamism (for the MEDA countries), basic needs unsatisfied, more rapid growth in per capita income, etc.

4.38 - The qualitative trends in demand

It is important to analyse these trends insofar as they may have important consequences on the location strategies of the clothing producers. Indeed, the demand for increased personalization of the product, the effects of fashion trends leading to the accelerated renewal of the ranges, are just some of the trends potentially favorable for a part of the production facilities remaining in the immediate vicinity of the final market, especially for short runs of « fashion » and « top-of-the-range » products. On the contrary, the basic products, where the consumer is more sensitive to the price effect, are increasingly likely to be relocated towards countries with lower costs.

4.39 - Technological evolutions

As with all industries, the textile and clothing sector is currently faced with extremely rapid technological evolutions, both as far as production processes are concerned as well as the very nature of the products. These evolutions, by transforming the very fundamentals of the activity, are likely to have a profound effect on the decisive factors of its geographical location within the EctFo-Mediterranean region. For example, the evolution towards more highly developed production technology, while reducing the role of unqualified labour, may create an obstacle to the relocation movement, linked to a search for low production costs. On the contrary, the development of technologies which provide for the remote transfer of data may facilitate the use of sub-contractors who are far from the final market.

4.40 - The offer and the players in the sector

After having described the industrial players and their strategies, based on a dozen case studies concerning large corporations in the Euro-Mediterranean region, dose attention will be paid to the trends at work in the distribution sector, which play a powerful role in the acceleration of the relocation movement of the industry through systematic strategies of sourcing from countries with low costs.

4.41 - Industrial actors and their strategies

4.42 - Overall description

The European clothing sector is overall very little concentrated. The companies are generally very small in size, since 85% of them employ less than 20 staff'. In France, the clothing companies, on average, only employ 73 people, against 130 in industry overall. Apart from the leather clothing and industrial clothing sectors:

- The traditional integrated manufacturers or own accounts :

  These are the classic manufacturing companies which combine the functions of design, production, and marketing. They therefore integrate the whole production cycle for different ranges of products. They possess their own production tools, in their own country and/or abroad. But today, only a much reduced number of own accounts undertake their own production on their national territory. Since the end of the 1980s, companies have gradually been reorganized in «mixed structures>>, bringing together, in variable degrees, three forms of production: own account production, subcontracts given and/or received (part time outworking so as to optimize the production tool in periods of under activity), finished product purchasing...

- The *principals* buy the fabric, keep for themselves the tasks of design and marketing of the products, and entrust the industrial manufacturing (which can go from cutting to make up of the products) to specialist companies, outworkers.

This enables them to offload the problems of production, technological investment, employment (management of staff, of social conflicts, of working time...) onto the subcontractor; on the contrary, they have to face the problems caused by the use of sub-contracting (quality of the products, delivery lead times...).

4.43 - Two types of principals are present on the markets:

1- Principals who have little by little rid themselves of their productive structure and no longer have a production structure, that are referred to here as "concept developers "

2- Partial principals, who along with their own production facilities also use subcontracting and/or purchasing techniques.

4. 44 - • Outworkers are subcontractors who carry out work according to instructions and are paid for the time spent in cutting and sewing the products. The outworker in the clothing sector does not therefore finance any stock of raw materials or finished products. Three types of outworker may be distinguished:

1. The traditional outworkers carry out tasks for manufacturers which go from cutting to make-up but also operations which require special know-how (embroidery...). They are vendors of clothing-making time who make their production facilities and their labour available, either to manufacturers who no longer possess their own manufacturing facilities or who find themselves faced with an overload of production, or distributors who want to have short runs made with reduced lead times that foreign subcontractors cannot make. They work from a schedule of specifications provided by the principal who also supplies the pattern with its indications, the raw materials and the ancillaries (zips, threads, buttons...). These outworkers, who are called upon to make basic products, are considered as simple agents bound to respect the expected level of quality and the lead times.

2. The outworker- entrepreneurs are outworkers who, in order to reinforce their position, have been led to modify their strategy in such a way as to adapt to the new working conditions imposed by the market. So as to bind themselves in a lasting way to the new principals and thus capture new outlets, certain have decided to widen their field of intervention by developing new skills. Thus, they propose their services for stages in the manufacturing process which until then were not covered by their domain of expertise: on the one hand, technical assistance (preparation of the schedule of specifications, making of patterns, of prototypes...) and on the other hand, advice for the development of a collection. Sometimes they are referred to as co-contractors.

3. The partial outworkers: in periods of under-activity, so as avoid partial unemployment, certain integrated manufacturers transform themselves into subcontractors and undertake work for principals.

4.45 Main Europe players & their textile strategies

4.45. 1 - Pinault Printemps-Redoute

Presentation. PPR moved into the luxury sector in 1999, with its acquisition of the Gucci Group. The latter designs, manufactures and retails high quality luxury goods. The Gucci Group is one of the top luxury multi-brand groups in the world thanks to its brands Gucci, Yves Saint-Laurent, Sergio Rossi, Boucheron, Bottega, Veneta, Bedat & co, Alexander McQueen, Stella McCartney and Balenciaga.

Strategy analysis. Apart from ready-to-wear, the group's offer includes handbags, leather goods, footwear, watches, jewellery, ties and scarves, spectacles, perfume, cosmetics and skin care products. The Gucci Group markets its products through the network of stores that it manages throughout the world (336 stores, including 173 for Gucci and 46 for Yves Saint-Laurent), in franchised stores and duty free boutiques, in department stores and specialist stores. In terms of price, PPR practices high prices for products with a luxury image, a guarantee of quality which creates customer loyalty.

Finally, the promotion activity targets a very specific patronage and uses international poster campaigns to show off the image of the products, as well as personal invitations for private sales.

4.45.2 - H&M

Presentation. H&M was created in Sweden in 1947 and today has 84 stores in 17 different countries. The business concept is « fashion and quality at the best price ». The industrial strategy aims at obtaining the lowest possible prices.
Strategy analysis. H&M sought to diversify its offer by launching into cosmetics. Its strategy consists in developing young « trendy » products at very reasonable prices.
International development. The group has no factory in its own name, but works with around 900 suppliers, half of them located in Europe and the other half in Asia (<< decentralized >> model, similar to that of Nike). It has 21 buying offices throughout the world: 10 in Europe, 10 in Asia and one in Africa. In terms of promotion, H&M is today present in 17 countries.

4.45. 3- Inditex

Presentation. The first Zara store opened in Spain in *1977.* The Inditex group is today composed of more than one hundred companies whose activities extend from design to production and to distribution, but only in the textile and clothing domain.
Strategy analysis. The business concept is very much oriented towards innovation and flexibility. The group seeks to position itself on all the links of the value chain, which explains the existence of the numerous subsidiary companies. Prices are relatively high. In terms of promotion, Inditex seeks to develop its sales through the web.
International development. The group's stores are mainly to be found in Spain and the countries of South America, but Inditex is also present in all European countries.

4.45.4 - Benetton

Presentation. The group was created in 1963 by Luciano Benetton who is still at the head of the business today. The mother company, Benetton SPA, is located in Treviso, Italy. Originally positioned in A the knitwear sector, it subsequently extended its activities to the ready-to-wear clothing sector for << men, women and children » as well as accessories such as belts and bags. Today, it has become highly internationalized and is developing into sectors such as sports equipment, motor sport, motorway restaurants and mobile telephones.
Strategy analysis. In order to achieve the largest possible market share, Benetton has developed a large number of brands which target various classes of customers: 15-30 years old with United Colors of Benetton (casual wear), known throughout the world for its advertising campaigns illustrating the theme of multi rariality through the photographs of Oliviero Toscani; female customers between 20-35 years old with Sisley (casual wear) ; 10-18 year's olds with Killer Loop (casual wear) and Play Life; sporty types with Nordica (Sportswear) and Rollerblade (skiing, skating, surfing...).
International development. Present throughout the world, Benetton nevertheless makes the major part of its turnover in Europe (69%), against 10% in North America and 9% in Asia. The company designs its products itself in Italy, but subcontracts a large proportion of its manufacturing, for the most part to countries such as Hungary, Croatia, Tunisia and Spain.

4.45. 5- Etam

Presentation. Created in Germany in 1916, the Etam group specializes in the design and distribution of women's fashion products (readyto-wear, lingerie, accessories).

Strategic analysis. Etam proposes three complementary brands: Etam, 1.2.3 and Tammy Girl, which enables it to cover the major part of the female clothing market. Etam offers women from 20-40 years old ready-to-wear products adapted to the needs of everyday working and social life, (town, sportswear), at reasonable prices; 1.2.3 targets a wealthy, more classic

clientele with city and professional style and is today one of the leaders of the top-of-the - range ready-to-wear segment with high prices. Tammy Girl offers young girls a complete range including lingerie, ready-to-wear, shoes and accessories, at very low prices.
International development. Each brand designs its own collections and calls upon a network of subcontractors throughout the world for its production. Etam achieves 58% of its turnover in France (58%), and is especially active in Southern Europe, in Belgium, in England and in China.

4.45.6 - Naf-Naf

Presentation. Founded in France, thirty years ago, by the Pariente brothers, Naf-Naf is today one of the European leaders in readyto-wear for men, women and children. Its turnover witnessed a rapid growth in the years 2000 and 2001.
Strategy analysis. -Naf Naf operates through three brand names: Naf - Naf (Female town clientele between 18-25 years of age' with two ranges – city wear and sportswear - at reasonable prices) ; Chevignon (wealthy male clientele between 25-35 years old, top-of-the range sportswear at high prices); NC Kids (city wear and sportswear for children and adolescents, at very reasonable prices.
International development. In 2001, the group produced more than 900 million units, in factories still partly situated in France, but largely relocated in the countries of Eastern Europe and the Maghreb. The group achieved 35% of its turnover outside France. It has sites in Europe, North America, South, America and Asia.

4.45.7 - Timberland

Presentation. Created in Boston (Massachusetts) in 1918, the company was initially a footwear manufacturer. It subsequently diversified its activities in the direction of the sale of clothing and accessories.
Strategy analysis. Timberland offers a wide selection of top-of-the range sportswear clothing, with two collections (United States and Europe).
International development. Timberland achieved 30% of its annual turnover in the United States and 70% overseas (Asia, Europe) in 2001. It is seeking to open production sites on each of the continents where it sells its products.

4.45.8- Lacoste

Presentation. Founded in 1933, the company initially manufactured a single model of shirt intended for the French market. From the 1950s, it undertook a twin diversification movement (ready to wear and accessories) and the international market (particularly through the granting of licences to foreign partners).
Strategy analysis. Lacoste, apart from shirts and polos, has gradually diversified its activity towards a much wider range of clothing and accessories (sports clothing and footwear, sunglasses, perfume, (Jean Patou), children's' collections, underwear...
International development. Lacoste seeks to sell its products throughout the entire world. It is currently present in 103 countries through a network of specialist retailers and in the 677 Lacoste boutiques and 1651 << corners >>. The design/ production of products is carried out by the Devanlay Group, a subsidiary of the DevanIay-Lacoste Group (own production and subcontracting), or through licence holders. Seeking the lowest production costs necessarily leads to the relocation of production activities towards countries with low wage costs (for example, Romania) and the closing of numerous sites in France (Bar-sur-Seine, Romilly-sur-Seine, Chaource...).

4.45. 9 - The increasing weight of the distributors

4.45.9.1 - Concentration of distribution in Europe

During the course of the past twenty years major shake-ups have been observed in the structure of European distribution, especially with the boom in new distribution chains, offering wide and varied ranges of products. Independent stores have seen their share of the market decline, to the benefit of the specialist chains, hyper and supermarkets, and to a lesser extent, mail order.

The progress in this movement is, however, very unequal from one country to another. Very marked in France, it is somehow less developed in the rest of Europe, where the share going to the retailers remains overall larger, with wide disparities depending on country.
For example, the market share of the independent stores remains very high in Mediterranean countries and that of the department stores and popular stores is high in the English-speaking countries.

4.45. 9.2 - The strategies of distributors and their consequences on the industrial offer

The growing power of the distributors

The specialist distributors and the large super- and hypermarkets have gradually increased their market share in clothing sales since the end of the 1970s. This movement has affected the capacity of manufacturers to determine the selling prices themselves. Indeed, this restructuring has been accompanied by a weakening of the traditional « manufacturer-wholesaler-retailer» distribution circuit which enabled the manufacturers to control their selling prices. These new distributors can make the manufacturers compete with each other, have an effect on prices and finally, penetrate the production activity, as a result of the weakness of the entry barriers. This phenomenon of the take over of power by the distributors has created a complete turmoil of the operational rules of the sector and the strategies of the traditional companies.

4.45.9.3 - The internationalization of distributors and the new outsourcing strategies

Affected as they are by the saturation of the European market, the large specialist and generalist distribution -companies seek in their turn to internationalize. They also attempt to differentiate their offer by turning towards a policy of brand/label, with collections prepared in advance and deliveries programmed in the stores, so as to increase the value of their brand in the eyes of consumers. Although the two traditional collections per annum continue to prevail, the distributors seek to offer 6 to 8 themes per season. Today, the distributors, through the intermediary of their buying offices, practice three types of outsourcing:

A. pure subcontracting, characterized by the negotiation of the purchase of the fabric and the payment of" the manufacturing time" to the subcontractor in relation to a model supplied.
B. controlled trading, or fixed price contract, where the model is supplied and the type of fabric specified in the technical specifications.
C. pure trading, that is to say the purchase of finished goods.

Today, there is a trend to the reduction in the market share of pure trading, which is now limited to opportunity products, peripheral products and brands, as well as a stabilization of subcontracting to a level of less than 50%, despite the direct gain in margin and a better control of the product. Finally, the development of controlled negotiation to the detriment of pure subcontracting favors the players capable ¯of providing an overall offer.

4.45. 9.4 - The development of house brands and the upstream move by the distributors

For a number of years, the distributors have been applying them` selves to what is for them a new profession, that of creator-designer. They participate in the collections, often manage their supplies of raw materials, and become directly involved in the process of creation and manufacturing. They finally build links with the national and foreign manufacturers and outworkers. Those manufacturers who work with the large supermarket chains thus find themselves faced with customers with a considerable purchasing power and are subject to very tough conditions for payment and lead times, rebates, discounts and promotional operations,in addition, the large chains are organizing themselves to develop their own brands by importing or having a part of their requirements manufactured directly abroad. There is therefore a movement upstream of the sector with the appearance of specialist chains which integrate everything from distribution to manufacturing, through the intermediary of subcontracting (indirect integration).

This movement concerns particularly the generalist distributor that is the mail order companies, the hypermarkets and supermarkets, as well as the department stores. Indeed, the very large volumes moved by these distribution channels give them advantages at several levels:

A. the development of house brands favors differentiation.

B. the control of the value chain provides important reductions in costs.

C. the considerable volumes handled by the buying offices give them increased weight and efficacy.

The arrival on the scene of the specialist chains also constitutes a phenomenon with considerable consequences. The footprint of the latter on the market makes it difficult today for players without a distribution network to take their place in the market.

In fine, the control of the distribution networks has henceforth become one of the most important elements of competitiveness. The distribution chains have, among other things, the possibility of granting longer production cycles than those of traditional manufacturers which do not integrate distribution, since they are sure to sell their products thanks to their access to the consumer.

The reaction of the manufacturers Faced with the growing weight of the distributors, the industrial manufacturers and outworkers have reacted by seeking increasing efficacy from their production facilities (flexibility, cost, quality) through increased use of technological innovation. A downstream integration counter-strategy has also been developed through the purchase of stores or the introduction of a distribution network. As for outworkers, in competition with imports, they have been forced to innovate and widen the range of their competence, with among other consequences, the birth of outworker entrepreneurs.

4.46 - Localization of activities: what attraction for MEDA countries?

The gradual opening up of frontiers, made possible by regulatory evolution, has led to a massive movement of the relocation of activities of the garment and clothes sector that may be illustrated by an analysis of the flows of direct investment into the Euro-Mediterranean region. This movement has led to increased competition, as well as a growing Complementarity between the different national industries of this zone, with each possessing specific advantages and handicaps.

4.47 - Regulatory evolutions: a gradual opening of frontiers'

4.47. 1 - Past evolutions

The efforts of the liberalization of trade undertaken within the context of the GATT; have always been faced with particular obstacles in the textiles and clothing sector, which led to a need for regulation. For more than 30 years, this sector was regulated by special regimes, the 1961 short term agreement concerning ,the international trade of cotton textiles, the long term agreement concerning the international trade of cotton textiles from 1962 to 1973, and the Multi Fibre Arrangement (MFA) concerned all textile fibres from 1974 to 1994. The decision to include this sector in the field of the multilateral trade negotiations in the 1986 cycle of the Uruguay Round was therefore especially important. Seven years of complex negotiations led to the Agreement on Textiles and Clothing (ATC).

4.47.2 - Present and future evolutions dismantling the MFA

The objective of the negotiations in this domain was to ensure a seamless integration of the textile and clothing sector into the framework of the 1994 GATT on the basis of reinforced rules and disciplines. The Agreement on Textiles and Clothing is a provisional agreement which was to rest in force for ten years and was not to be extended. Its main provisions were designed gradually to eliminate the quantitative restrictions, particularly the bilateral contingents negotiated within the context of the Multi Fibre Arrangement (MFA). The restrictions, applied under the *MFA,* which were in force on 31st December 1994, were carried over into the new agreement and to be maintained until the designated products are integrated into the framework of the 1994 GATT. Integration signifies that once the product is integrated, trade in this product is governed by the general rules of the 1994 GATT. The integration program comprises four stages and all the products must be integrated from the 1st January 2005.

As concerns those products which continue to be subject to restrictions, at whatever stage in the transition period, the Agreement sets out a formula which enables the existing growth coefficients to be increased. As long as one particular category of products is not integrated, the importing country members may apply a specific transitory safeguard mechanism against a determined exporting country, if certain conditions dearly set out in the Agreement are met.

4. .47.3 - Regional agreements: the creation of the Euro-Med area and its objectives

The Euro-Med process was launched in Barcelona in 1995. Its objective is the creation of a vast free trade area, on the model of NAFTA, between the European Union and the 12 Mediterranean countries of the MEDA region. Beyond a reciprocal lowering of customs duties and an opening of the markets, the project provides ideally for the establishment of a common external tariff, a common trade policy, and unified rules in terms of competition, markets and standards. It aims to increase the global competitiveness of the area, trade between partner countries and the development of each of the signatory countries.

This project has had particularly far-reaching consequences for the textile and clothing sector by encouraging the development of trade and the enhancement of complementarities between the North and South regions of the Mediterranean.

A self-sufficient area, with a globally stabilized textile industry in tie-ins", of employment and production, could see the light of day alongside the other large integrated zones: Asia and NAFTA.

The manufacturers would find here all the components of an integrated sector and thus avoid having to face the costs and the logistic complexity of distant relocations.

4. 48 - A powerful movement for relocation outside Europe

4.48.1 - A little history

The textile and clothing industry has historically been one of the main driving forces of the industrialization of today's developed countries, such as Western Europe, North America and Japan. But since the 1960s, this situation has been upset, with the new producer countries providing increasingly heavy competition for the industries of the North, which has been made possible by the opening up and the internationalization of markets. While the developed countries, with Western Europe in the forefront, still dominated the main trade currents in 1960, this supremacy has gradually been shaken by new producers from the South.

Initially, relocation mainly concerned the downstream operations of the sector, that is to say the clothing industry. In fact, textiles are a capital intensive industry with heavy and sophisticated production tools which are difficult to transport. On the contrary, in the clothing field, the capital investment remains limited and labour represents a large part of the cost price of the product.

Today and tomorrow a movement may be seen, however, towards the higher technology professions such as the transformation of textiles. The whole of the sector is therefore gradually being reconstituted outside the early industrialised countries. Whence a gradual increase in the trade deficit, linked to the rapid growth of imports (+350% for Western Europe between 1980 and 1994), which the explosion in exports (270%) has not managed to compensate. In 2001, the European.

4.48. 2 Textile – clothing: A world market

Now: USA + EU + Japan = 80 % of world imports: from 1.1.2005 the Big Bang, and after the end of 40 years of Multi – Fiber agreement, and China factory effect of the world.
In view: wide “co – operation zones”: we will have three textile market; the first one USA with Mexico and Latin America, the second one Japan with Eastern Asia, and the third one Europe (enlarged) with Mediterranean countries.

Become a key actor in the textile-clothing supply chain in the PAN EURO –MED area. 41 countries, 7 million workers, 250 billion € of industrial production, 70 billion € of export, 700 million consumers.

4.49 -The incentives of the internationalization in the Textile industry

4.50 - 'Relocation has been made inevitable by a series of factors:

4.50. 1 **The differential in labour costs**. The differences in the cost of labour between the developing and developed countries explain, to a large extent, the loss of competitiveness of the latter. Thus, for example, the cost of one hour's work in France represented the equivalent of 60 hours in China, 10 hours in Tunisia. For this reason, whatever the extra costs of a relocation (supply costs, customs duties, etc.), French manufacturing would no longer seem competitive for bottom to mid range products.

The opening up of markets and the lowering of international transport costs, which in the past were large obstacles to the circulation of goods.

The cost of sea freight has dropped by 40% in constant francs from 1985 to 1992, air freight by 30%.

4.50. 2 - The inequality in competition conditions: industries in developing countries benefit from other "competitive advantages" such as the absence of labour legislation, environmental protection. Moreover, counterfeiting also contributes to the tarnishing of the prestige of a brand, since counterfeit goods are rarely of an equivalent quality to those products counterfeited. It is estimated that this prejudice is 5 % to 10% of the turnover of the European clothing industries.
• Other factors: geographical proximity, the productivity of the personnel and its know-how, the state of the infrastructure, local fiscality.

5.50 .3 - The forms of relocation
Relocation, that is to say the transfer of production, takes different forms:
• Relocation with capital investment: this involves the creation of a subsidiary or a merger-acquisition. In this case, the company acquires a factory with manufacturing facilities which will be used for all or part of its production. The company takes the maximum risks: If there is a drop in orders, or a rise in the cost of labour, the cost of changing the manufacturing site will be high.
• Relocation without capital investment: here the concession of a licence or subcontracting will be used. In the case of a licence, the manufacturer grants a foreign company a licence to manufacture in return for royalties. In the case of subcontracting, the principal asks the foreign subcontractor to manufacture a product for him for which he will also provide a schedule of specifications and often the raw materials. The principal who subcontracts may interrupt his orders at any moment, or modify his quantities.
•International trading: this is an accessory form of relocation since the company purchases products to resell them.
• There is a difference in the forms of relocation depending on the type of products. In the "knitted fabric" activity, which requires lesser skills, the proportion of subcontractors, simple "order takers" from European companies is higher; on the other hand, in the ¯warp and weft" activities, which require more highly skilled labour, the proportion own brands (European manufacturers who have relocated or co-contractors) is greater (this is particularly the case for Turkey).

4. 51 - High Complementarity between the countries of the Euro-Mediterranean region
Within the Euro-Mediterranean region, the relocation phenomenon has taken out another dimension if it is analyzed in terms of the exploitation of the potential complementarities which exist between the different countries. The intensity and nature of current trade flows, in fact show that there has been an international division of labour: specialization of Western European countries upstream of the sector (textile products) more intensive in capital and in R&D effort, specialization of the MEDA and CEEC countries downstream (clothing) which are more labour intensive.
1. The Euro-Mediterranean region is by far the largest export market for textile production in the area, in particular, the MEDA and the CEEC countries represent (excluding intra-European trade) the main international outlet for West European textile products.

2. The share of the CEEC countries and the countries of the Mediterranean basin in the European clothing imports has tended to grow, at least until the beginning of this century, to the detriment of Asia and NAFTA. Symmetrically, Europe represents currently, and by far, the main outlet for exports of clothing products of the MEDA and CEEC countries: 83% in 2002.

The same phenomenon has taken place within NAFTA, the creation of which has contributed to a reinforcement in American regional integration. It is for this reason that, in 1999, Mexico

has become the leading clothing supplier to the United States, and in 2000 represented 20% of American imports. Conversely, at the same date, Mexico accounted for 36% of the textile exports of the United States. Other countries from Central America, such as Honduras or the Dominican Republic, also witnessed a rapid increase in their trade with the United States. This free trade area has enabled the imports from Asia to be contained in a while, for in the year 2000 it represented only 56% of American clothing imports. In the recent year, nevertheless, US imports from Asia and especially from China boomed again.

4.52 - The rise in relocation towards CEEC countries

Until the beginning of the 1990s, the regional integration movement within the Euro-Mediterranean region had above all benefited the MEDA countries (Turkey, Tunisia, Morocco, especially). But, since the end of the 1990s, an increasingly significant part of European relocations have been towards Eastern Europe. An analysis of the AFII/Ernst and Young data base enables a certain number of conclusions to be drawn on the recent evolution of job creation linked to << Greenfield >> investments:

• The amount of international investments in the sector is apparently low (17,000 jobs created in the sector between 1998 and 2002 against 150,000 in automobile equipment.

This is probably linked to the fact that the relocations frequently take the form of subcontract flows rather than direct investment.

•Despite the presence of some logistics/ distribution projects, almost all the jobs created concern the production function, the most part the projects originate from West European counts: Germany, Italy, and United Kingdom

• The location behavior is different in the case of clothing - where the low wage cost countries of Eastern Europe carry off a very large part of the market - and in that of textiles, where the share of developed countries is much higher.

Econometric analyses which have been undertaken elsewhere on the AFII data base confirm that the « wage costs » variable is highly explicative of the location behavior of clothing companies, while it is less the case of textiles, where other variables (GDP, GDP per capita, etc.) are equally significant.

• It should also be noted that the position of developed countries is better in terms of numbers of projects than jobs created. In other words, there still exists a large flow of textile and clothing projects towards the developed countries, but they are small in size, or poor in jobs and technology and know-how intensive.

5.53 - Assets and handicaps of each territory

Is the growth of Eastern European countries to the detriment of the MEDA region?

Historically, it was rather in the direction of Asia and the MEDA countries (Tunisia, Morocco and especially Turkey) that the initial relocation flows were oriented, in the form of direct installations, or, more frequently subcontracting with local outworkers.

Conversely, relocation towards the countries of Eastern Europe is a more recent phenomenon (end of the 1990s), given the recent opening (excluding the special case of Yugoslavia) of these countries to trade flows.

Today, the MEDA countries already have fierce competition from East European countries such as Romania to supply the European market and for the location of manufacturing investment projects. In this respect, the situation today for the MEDA countries in the clothing industry is almost the opposite of that observed in other activities (such as the automobile industry) where these countries have so far trailed behind Eastern Europe in their integration into the European industrial networks. In the case of the clothing industry, it is rather an existing integration,

relatively low key but incontestable, which would seem to be threatened by the arrival of new competitors from Eastern Europe.
This risk may be illustrated by the comparative importance of the relocation movements in the clothing industry in Eastern Europe and the Maghreb during recent years:
• It is in the « Eastern Europe» zone that the majority of clothing projects relocated in Europe has been located in the past 5 years. This movement has largely been the result of producers of European origin or those located for a long time in Europe.
`• The comparison between MEDA/Eastern Europe is possible, only for the number of projects and for the year *2003* from the Europe and MIPO observatories of the AFII and ANIMA. These numbers show that the countries of the Mediterranean basin remain an important reception area for projects. They have, however very stiff competition from the East European countries. There also exist examples of relocation from the Maghreb or Turkey towards other areas: second generation East European countries, China...

5.54 - Assets and handicaps of the various territories of the Euro-Mediterranean region compared

General considerations
The following groups of countries will be selected for this exercise: Western Europe (with a special focus on France), first generation CEEC countries (Yugoslavia, Poland, Hungary, Czech Republic), the remaining CEEC countries, first generation MEDA countries (Malta, Tunisia, Morocco, Turkey), finally, the remaining MEDA countries (with the exception of Israel, whose characteristics are rather similar to those of Western Europe):

In terms of wage costs and productivity, the first generation MEDA countries remain better placed than the first generation East European countries, but are less competitive than the other East European countries, the Mashrek countries and Asia. For this reason, they themselves face the risk of the relocation of production activities towards these countries.

In terms of regulations, there still exists a dissymmetry of treatment between three categories of country:
- The MEDA countries concerned by the agreements of association with the European Union, which already offer substantial advantages for access to the European market, but which themselves are integrated into a regional Mediterranean free trade area;
- The East European countries likely to become members in the short term of the European Union, and which, as a result, will very quickly benefit from the advantages of a large integration market without any obstacle to trade;
- Finally, all the other countries (especially Asia), still subjected to the MFA quotas but which will see these quotas lifted from the year 2005.
However, in the midterm, the general trend is that of the opening up of the European market to imports of all origins, which may well mean a certain erosion of the relative advantage which the MEDA countries have enjoyed, in this domain, within the context of the Euro-Med agreements. It should, however, be noted that the free trade agreements signed or about to be signed with the United States (Jordan, Egypt, Morocco, Israel,..) give an extra advantage to the countries concerned.

• In terms of market proximity, transport and logistics, the existing networks, after several years of operation, have proved their reliability. The European principals can be supplied from

Tunisian and Turkish sites in good conditions of cost and respect for lead times by their suppliers, especially in the case of Turkey.
• In terms of industrial environment and know-how, the essential of the research, innovation and product design capacities are still today concentrated' in the West European countries.
In certain first generation MEDA countries (Tunisia, Turkey), the existence of an already established clothing activity has enabled the emergence of embryonic" clusters" in certain regions. For example, the activities of design are developing considerably in Tunisia, as evidenced by the project of the Cite de la mode envisaged at Carthage, with a duster featuring a school, styling, design, and production.

The upstream parts of the sector seem to be developing gradually as is evidenced by the significant flow of investments, especially of foreign origin, in the textile activity.
However, integration into the textile sector remains unequal from one country to another, especially those which are not blessed, as is the case for Egypt, with natural Fibre resources (cotton).

4.55 - Local stakes linked to the new Euro-Mediterranean economic geography
The formation of a large Euro-Mediterranean economic region means, in the textile and clothing sector, as in the remainder of the activities, a recomposition of industrial geography. This movement is linked to the creation, by the firms concerned, of transpational networks of production and trade, the aim of which is to use, in the best possible way, the specific advantages of each area by specializing in those activities for which it would seem to be best fitted. For the different reception areas, the stakes therefore consist in developing, in the particular segments of the sector," centers of excellence" which give it an advantage which differentiate it as an attraction for activities which belong to this segment.
However, the rapid evolution of the markets, technologies and especially the continual arrival of new areas and/or countries on the map of potential reception territories have the consequence of permanently transforming the terms of this problem set, which may only be understood within a dynamic perspective.

• It is in this way that the first generation CEEC and MEDA countries (as moreover did certain countries of Southern Europe, such as Portugal or Malta, a little earlier) initially based their attractiveness on the weakness of their wage costs. They now find themselves faced with competition from countries with low costs (Romania, China, and Bulgaria), towards which the new labour projects are locating. They are therefore forced to attempt to « move up market » by offering more luxurious fabrics or better quality or more innovatory garments. They may also seek to consolidate the upstream of the sector and constitute integrated « clusters » which enable them to better resist the competition from countries with very low costs. Malta, which itself suffered the consequences of this movement as early as the 1980s, to the profit of the Maghreb countries and Turkey, sought for example to compensate the inevitable decline of its labour intensive industries by positioning itself as the reception centre for a logistics hub, a centre of shared services and design for the whole of the Mediterranean area, by practically abandoning production activities. But this reconversion, which led these countries to turn to activities where they were to find themselves increasingly in competition with Western Europe, forced them to make an increased effort in training the labour, bringing the local companies up to standard, converting condemned activities, improving the general business environment (free trade agreements with neighboring countries, modernization and updating of infrastructures, etc.).

The Turkish industry is a good example of this problematic: it at first played the role of subcontractor for the principals in Europe by assembling bottom-of-the-range products from imported European textiles. A certain number of companies subsequently turned towards co-contracting for mid-range products, whereas the country was hosting an increasing number of European investments in clothing and the upstream of the sector (textile) was developing. Finally, there appeared Turkish principal companies with their own brands and design capacities. For some time, these firms have themselves been investing abroad, especially in Western Europe, by purchasing local clothing firms in difficulty, with the aim particularly of acquiring their distribution networks. For 6cample, the company Retro Tekstil San, created in 1996, firstly acted as a subcontractor for foreign companies, with 50 employees. After rapid expansion, it created a joint-venture with the British company Desmonds & Son. Today it employs 1,200 people and has developed a complete line of jeans, trousers in cotton and synthetic and artificial fibres intended for consumers throughout the world.
• As for the second generation MEDA and CEEC countries, they obviously gain the essential part of their competitiveness from their low labour costs, which places them in a good position to accept clothing projects which require unskilled labour. In certain particular cases, such as Egypt, they benefit from important natural resources (cotton) which represents a potential factor of attractiveness for the upstream part of the sector (textile spinning). So as to position themselves on this segment, they must nevertheless offer potential investors or principals a minimum of guarantees in terms of legal context, logistic networks, political and social stability, and benefit from the opening' of the Western European markets to their products.

• **Market opportunities:** the increasing demand for personalization, the accelerated renewal of the ranges, the necessary reactivity to the effects of fashion, constitute as many factors which encourage the location of production close to the European market: the creators need to be able to sense the mood of the moment and supplies to the points of sale need to quick. Thus, producers, the likes of Zara or Kickers, who have based their competitiveness on these principles, manufacture in Europe (respectively Spain and Belgium) a large part of their products. Chantelle has succeeded in maintaining its level of employment in France by specializing on its French sites in activities with a stronger content in innovation and in added value, while relocating its mass production

• **Technological assets:** the image of a textile industry employing unskilled labour with low intensity research is already a thing of the past. The development of the fabrics of the future (anti-stain or anti-perspiration, water repellent, thermal regulators, photo protective, biological sensors,....) assume an evolved technological environment that only the developed countries offer for the moment. In the clothing field, introduction of better performance machines (evolved sewing machines, computer-aided production), without enabling the complete automation of the make-up phase, which is the heaviest in labour terms, will provide for a reduction in the production cost differentials.

The results are already there to be seen:
The American producer GSE, for example, has just invested 2 million euros in its site at Rechlin in Germany to increase its production of geosynthetic textiles.
France, 2°d European country for geosynthetic textiles, capital of fashion and innovation in textiles with its Parisian trade shows like Texworld, Expofil, Premiere vision, Mod'amont, Made in France, has immense assets to exploit.
The European clothing industry could then find a new equilibrium, based upon the production of short runs, for high added value products (textile and design) and implementing modern production tools. It would offer employment opportunities, without doubt fewer in number, but also more highly skilled than in the past and more

oriented towards the functions of conception, management and logistics. It could be assisted in this endeavor by its natural partner, the Mediterranean clothing industry

4.56- Recommendations for the MEDA countries

The foregoing analyses lead to the recommendation of certain number of guidelines for actions likely to reinforce the competitiveness and attractiveness of the textile' and clothing sector in the MEDA region.

4.56.1 -Intensify regional solidarity

Certain cooperation already exists between the MEDA countries, but at an unsatisfactory level:

• Precisely as concerns textiles, the Agadir process is interesting, but it is obvious that it only affects countries which do not have a common land border (Morocco, Tunisia, Egypt, Jordan); this cooperation must absolutely be extended to the whole of the Maghreb and Machrek so as to create a meaningful internal market ;

• The Barcelona process would seem rather to be suffered than to be controlled by the various countries of the MEDA region. It can only be seen to exist, with a few exceptions, through the European initiative.

These observations are political, and involve difficult negotiations between regimes which have not managed to over' come their differences or disputes, at the risk of fragilising certain sectors of their economy. The lines of action proposed in this domain derive above all from trade agreements:

• The reciprocal opening of the markets of the MEDA countries so as to guarantee more important local outlets for the manufacturers in the area; for sure, the MEDA domestic market only represents one eighth of the European market (the main outlet), but it should grow much more quickly.

•Constitution of an integrated Euro-Mediterranean area to provide mutual outlets between European textiles and MEDA clothing.

4.57 - Escape this logic of dependence

All the foregoing analyses show dearly that despite the often calamitous situation of its textile industry, it is still Europe which has the touch for organizing the sector, attempting to conserve high added value productions, choosing where to relocate that which has to be relocated. Europe (or more generally the OECD sphere) is in the position of principal, thanks to its leadership in fashion, its brands or its distribution networks, while MEDA is in a subcontracting situation.

This domination may be analyzed as largely cultural - among other things, it uses the media channels, publicity, movements of opinion, and the behavior of the leaders. It also relies upon a better << societal » organization (free flow of information, reactivity of the companies, construction of the economy around profitability). The result is, in textiles as in the majority of sectors, that it deprives the physical producer of the greater part of the value, to the benefit of the researcher, the conceptor-designer, the publicist, the logistics expert, the distributor etc. MEDA then has, on the one hand to aspire towards more dignified physical productions, and on the other hand needs to be able to ¯wrap up" this physical production in a range of more rewarding services.

The lines of action proposed are a matter of industrial policy:

•Upgrading the industrial companies of the MEDA countries (transformation of subcontractors into co-contractors or brands).

• Improving the range of productions: following the Asian example, reorienting the sector towards the production of more competitive local fabrics.
Targeting investment strategy: for example, the cotton producing countries (Syria, Egypt) may have an interest in developing weaving; it is frequent for cotton shirts made for the well-known European brands to use cotton fabric of Italian origin.
Acquiring brands or distribution networks in Europe or the creation of brands intended for the regional market (cf. example of Turkey), or those which play on the image of the Mediterranean.

4.58 - Launch a reflection and initiatives for the development of the sector
Beyond the previous actions, which above all concern the industrial companies, what roles can the MEDA investment promotion agencies (IPA) make their own?
The first actions which come to mind are a matter of knowledge and reflection:
• Inventory of the strong points of the sector in the MEDA countries. From research, to textile materials, not forgetting know-how (lockstitch, embroidery, as well as software etc.) or the production-distribution circuits, identifying the specific assets of each of the countries to then be able to make choices (targeting) and harness them.
• Research new production-distribution niches through a marketing approach. For example, play on the links between tourism and clothing by using image and fashion (<< ethnic » garments for holiday wear, or sectors such as sailing or water sports).
•Research activities with a high labour content, such as finishing or embroidery, for example.
Elsewhere, promotion actions may be envisaged to attract or incite new companies-or initiatives:
• Cooperation with the European regions on relocation. Regions like the North of France or Italy no doubt prefer to see their textile industry part into the MEDA region rather than China. The aim is to assist in partial relocations, by attempting to conserve the subcontracting and distribution networks, while taking advantage of proximity. Certain
` European operators would be sensitive to an offer of assistance which counterbalances the lesser attractiveness of MEDA in terms of costs. A professional syndicate such as the Union of Textile Industries in France is open to a reflection on a Euro-Mediterranean strategy for the textile sector.

• Constitution of centers of competence, profession by profession (for example, knitting, craft weaving, technical fabrics, design and fashion, etc.) by attempting to bring together training (schools, professional centers), research, studies and market knowledge, logistics and distribution in a given place (<< cluster » or « valley »). This is what Tunisia is attempting to do with the Cite de la Mode at Carthage.

• Organization of promotional events (open days, fairs, fashion shows etc.). It may be an idea to organize open days or workshops devoted to MEDA in certain trade fairs in Paris or Milan rather than creating a specific forum dealing with Euro-Mediterranean textiles.
The MEDA countries could in this way reinforce their natural complementarities with the West European countries with high labour costs:
• For the European countries, the challenge is rather for them to reinforce their attractiveness for the niches which require highly skilled labour, in a high performance business or technological environment, or even activities linked to market access (e.g.: rapid production of short runs to satisfy the day to day evolutions in demand).
• For the MEDA countries, it is a question of taking advantage of the opportunity that the rapid rise in costs in the CEEC countries represents and the necessary relocation outside Europe of labour intensive activities. A MEDA offer should be conceived explained, promoted. It

would have that much more weight if the MEDA countries could unite to propose a common vision and an integrated market.

4.59 - Current consumer trends in the developed countries

The identity of the individual and his relationship with others the thirst for accomplishment

The act of consuming corresponds increasingly with the search for personal accomplishment. This behavior contributes to the success of the specialist labels which promote personal development in its different forms: physical, manual, or intellectual (e.g.: the concept of (physical condition in the Decathlon stores). Leclerc have created cultural spaces in the shopping malls. Electronic business also provides an answer to this thirst for accomplishment through the creation of sites entirely devoted to leisure.

4. 60 - The concern for personalization

The customer claims his own identity, which makes him sensitive to the personalization of products and services he buys. Few store chains respond to this trend at the moment due to the cost factor and the difficulty of practicing too fine a segmentation of their customers in the mass distribution circuits. Certain interesting initiatives can be mentioned concerning, for example shirts (Devianne), shoes (La boutique sentimentale or Cherry), women's undergarments (Alice Cadolle) or belts (Losco) which may be purchased made-to-measure at reasonable prices. Electronic business also offers interesting responses through «profiling», for example, which helps orient a customer towards products likely to be of interest to him or her, on the basis of his/her past behavior or purchases, or his/her socio-demographic characteristics. For example, Kickers Belgium proposes to its consumers that they create their shoes themselves on Internet.

4. 61 - The need for a social bond

Customers also seek contact and integration, and thus products which link individuals one to another by identifying them to a group of consumers who share the same interests and emotions. Certain very specialist distributors seek to satisfy this need. Hence the store The Shop (selling sports equipment and clothes for young people) has become a meeting place for lovers of skateboards, rollers, street wear, rave, etc. Apart from a very wide selection of clothes, customers will find a bar, DJs mixing live, a space for tattoos or piercing and a large table on which are piled adverts for evenings out, for records and free sheets. However, the distributors have a problem exploiting this trend, since the acquisition of legitimacy vis-à-vis the groups concerned is difficult, especially for the mass banners. This creation of a social bond does, however, seem so much easier on Internet, since the network enables individuals to connect according to their centers of interest. Finally, children take an increasingly important place in the consumption process, both as prescribes and as consumers. Hence the development of banners which take this reality into account as Du pareil au meme.

4. 62 - The demand for virtue

This trend can be seen through the value given to products and services which promote respect for the environment and Man. Distributors seek ~to respond to this expectation. Carrefour has, for example, introduced a code of social conduct to encourage suppliers to respect human rights in the workplace. Leclerc promotes a militant «consumerist» dimension

4.63 - The relationship with time

This dimension may either concern the past (with increased appreciation for all the products which promise authenticity and arouse nostalgia) or the present (feeling of urgency).

5 .64 - The search for authenticity and nostalgia
The consumer is turning more and more towards his roots and his past, whether his personal history or that of Humanity Several specialist banners answer this need by creating, in their points of sale, decors which suggest a special atmosphere or period (e.g.: Chevignon).

4.65 - The feeling of urgency
The feeling of being short of time drives the consumer to seek a rapid and immediate buying and consuming act. Hence the success of the banners which offer time saving or limited waiting: home delivery, late opening hours, absence of queues, possibility to undertake several activities at the same time. Carrefour proposes that loyal customers use a fast check-out, for example. Inte-miarche offers hurried customers the most indispensable products dose to the check-outs.

4. 66 - The search for positive sensations
Faced with difficulties of all sorts (unemployment, sickness, divorce, solitude...), the consumer turns to those products which bring him a feeling of security Hence a need for advice and information as well as the growing role of guarantees (labels, certifications etc.).

4 .67 - The demand for simplicity and practicality
In front of a consumer anxious to avoid unnecessarily technical products or combinations of purchases that are too complex, the distributors reply with an offer of simplified products or complete ranges of services. For example, Le Printemps proposes to take in charge the whole of a couple's future marriage, from the invitations to the honeymoon. Celio or La City offer simple, basic products with a reduced assortment. Finally, Internet constitutes a particularly simple and practical distribution channel where access to information is made easier by search engines and sites for comparison.

4. 68 - The search for emotions
Faced with a consumer in search of pleasure, the specialist stores seek to create a pleasant environment centred on specific products (Zara, etc.). Certain brands create ephemeral stores which only remain open for a month or two. For example, in January-February 2000, Lanvin opened an ephemeral store in an apartment, centred on the theme of the five senses. It is an important competitive advantage for specialist distributors, insofar as the generalist distribution and the electronic merchants experience more difficulties in responding to this search for pleasure.

4. 69 - Some emerging trends

4. 70. - The abandoning of property as an investment
For a long time, consumption was confused with the accumulation of an estate and the most important quality for a product was that it would last. Today, the immediate usefulness takes precedence and products are becoming ephemeral, even disposable or interchangeable. Hence a multiplication of stores which operate on the notion of barter or exchange, or trade-in services for second hand goods, loan or rental outlets: Trocathlon (Decathlon). This trend still remains marginal today at least in France.

4. 71 - The gradual disappearance of frontiers
With the disappearance of strict norms, the increase in crossbreeding and fuzzy logic, the traditional frontiers between products are tending to disappear. Hence, the perfume chain Baiser Sauvage sells beauty products and lingerie. The chain of clothes stores “Antoine et Lili enriches” its offer with a florist, a delicatessen and tea-room. The store Colette sells both clothes, CDs, objects of decoration, cosmetics, and books and houses a restaurant.

4 .72 - . The main technological innovations underway in terms of process & Product
Process innovations

They take very different forms in the textile domain and that of clothing, which will be reviewed here. In fact, the clothing manufacturers • invest in a less capital intensive and a more diversified way than textile manufacturers. To remain competitive, while keeping reactive, the manufacturers must modify their strategies in such a way as to make savings in raw materials, reduce labour costs, increase labour productivity, improve quality control and generalize the short production circuit.

• Creation has experienced considerable progress in recent years with computer-aided design (CAD). The stylist draws with an electronic pen, digitizes the range of fabrics selected and scans several possible color ways, all very rapidly. This technique enables a design to be created straight on the screen, stored, and modified; motifs, colors, fabrics may be retrieved at will, and the data bases may be consulted without limit... Other than a saving in time, this three-dimensional simulation enables several models to be displayed and tested with the end result very dose to reality (taking account of the fall of the fabric, its transparency...). Basic image enhancement also allows the retrieval of models from the other collections for them to be brought up to date. The grading software enables the production of the different sizes automatically.

• The phases of design, pattern-making, cutting and assembly of the prototypes took place well before line production existed. But with computer-aided design, all the operations can be carried out almost simultaneously. The organization of the work retains its sequential aspect, but the duration of each sequence reduces. The CAD software assists the manufacturer, from the design of a garment on the screen to the preparation of the control times and the risk of errors and enabling the pieces to be laid out more quickly, and with savings in fabric.

• Computer-aided manufacturing (CAM) has provided more efficient technology from the spreading operation (which consists of superimposing several layers of fabric which will be cut at the same time) to the cutting of these layers. The new generation of spreader is run by a microprocessor which controls its movements allowing time savings in handling and providing a quality control of the fabric. This is made possible by automatic spreaders which work with much greater precision and high speed. The <<lay-out>> operation which keeps off cuts to the minimum, by optimizing cutting, is nowadays computer-aided. Thanks to "interactive" lay-out, the most often used, the cutter arranges the different pieces to be cut, displaying them on the computer screen, and the computer gives the effective use rate of the whole surface of the fabric. In the case of automatic lay-out, the cutter merely has to enter the data and the software does the work. Finally, cutting is carried out in relation to the pre-recorded layout: the cutting head with its vertical blade is guided by the computer. It also requires a vacuum cutting table which stops the layers of fabric from moving as it is cut.

• In terms of assembly, as with handling, the progress has been considerable. Modern sewing machines are equipped with numerous improvements and the robots can carry out simple operations, such as the sewing of buttons, buttonholes, pockets... The pieces are transported from one work station to another along a network of rails and points which reduces the intermediate stocks and hence manufacturing time. When the garment is finished, it merely requires pressing in the automatic tunnel press before being subjected to quality control and packaged.

• The garment make-up operations represent the least automated phase and still require an abundance of labour. Advances in technology have, of course, enabled the sewing-up time to be reduced, and both the number of stitches performed and the threads handled simultaneously to

be increased, but not all sewing machines are automatic. It is therefore still the seamstress who carries out the sewing-up operations and who controls her own work directly.
Electronic data interchange (EDI), the remote transmission of commercial, logistic and financial data, using standard formats, enables manufacturers, outworkers and principals all to work in real time. EDI is a common tool which is used to define and standardize the schedule of specifications of a process underway. These organizational modifications, based mainly on the interchange of computerized data on sales, orders, raw materials used ... contribute to a modification in the relationships between manufacturers and suppliers of raw materials and between manufacturers and distributors and reduce the product design and manufacturing cycles and thus minimize stock levels.

4. 73 - Product innovations

The European textile industry, in fierce competition with the weavers of the Third World, is doing everything to rid itself of the image of an obsolete activity. For a number of years, micro-massage tights, anti-UV-A fabrics or antibacterial socks have been available on the market. In this industrial sector, so symbolic of the former economy, innovation is both creative and dynamic.

• The development of informatics and the considerable progress made in micro-electronics are in the process of discreetly revolutionizing the industry, even if many products are still at the prototype stage. LnteUigent clothing fitted with electric wires and chips in the body of the fabric, will enable the integration of an MP3 player, a mobile telephone, speakers... and despite all this equipment, they can be machine-washed.

• In the medical field, these technologies have a wealth of applications. Garments that measure blood pressure, the pulse and body temperature and warn the doctor in case of a problem are currently under experimentation. There is even a«Pace protector» T-shirt which protects carriers of a Pacemaker from the electromagnetic waves emitted by portable phones.

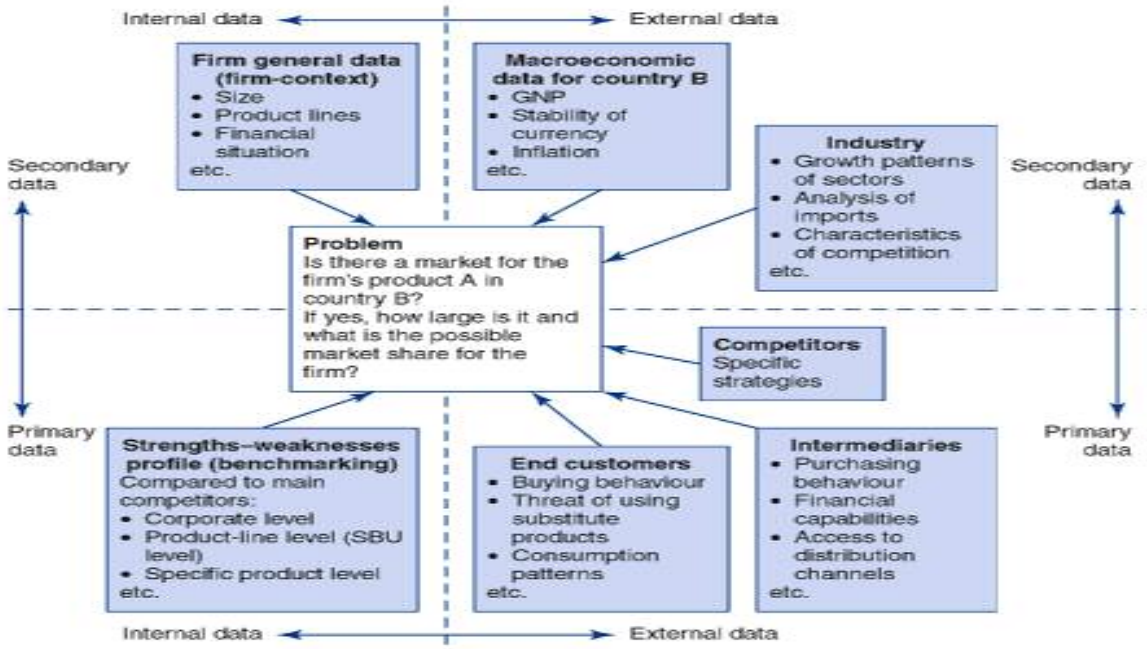
• In the military and security domain, the new fibres (Kevlar, Twaron, and Keimei) are treated to make them ultra-resistant, antistatic, fireproof as well as water-repellent and they can be equipped with electronics so that, for example, they may warn a firefighter of the presence of poisonous gases.

• In the logistics field, within a few years, intelligent labels should be able to simplify stock control for textile manufacturers while providing more efficacious protection against counterfeiting. On Internet and even within the fashion boutiques, virtual fitting should be a popular feature.

• The fabrics of the future are already present, thanks to the use of a technology, fairly widespread in the food industry, micro-encapsulation. Micro-encapsulation technology has caused an enormous shake up in the sector. Invented in the 60s and used mainly in the agro-food business, cosmetology and pharmacology, it consists of encapsulating an active substance (perfume, medicine, pigments) in a spheroial membrane. These micro-capsules are then applied to the fabric using a coating or vapor deposition technique. This process can be used, for example, to create fibres which change color. It is possible to find on the market blinds which change color depending on atmospheric pressure, temperature and humidity in the same way, the micro-capsules are used as a medium for the slow diffusion of antibacterial, carotida or fungicidal treatments on textiles. This technique is used for fabrics or linings which are required to create a "micro-dimate" around the body. People will be warm outdoors and still comfortable when they get on the subway or go into a restaurant this is a possibility when the capsule embodies technological paraffin called <<Confortem>>, which is a phase transition thermal regulator.

• Another channel of research for inventors of textiles, the technique of «grafting» which consists in grafting onto a molecule new chemical functions, by depositing another polymer in thin layers. This is how a fabric can be made water-repellent sweet-smelling or stain-resistant. The 1FTH (French Textiles and Clothing Institute) has developed a prototype technology of radio-grafting by very high speed electron bombardment. Their priority is to study the photo-protective molecules for both the cosmetic and the textile industries_ what are lacking are substances capable of protecting against both ITV Bs (which give a suntan) and UV As (responsible for skin cancers). The aim is therefore to create molecules which copy natural substances capable of combining the two forms of protection. This could be used to manufacture clothing for children to wear on the beach, for example.

Figure A.1 **Categorization of data for assessment of market potential in a country**



4- 74 History of the international agreements concerning the textile and clothing sector from 1960 to date

4 .74. 1 - Agreements concerning cotton, cotton-based products (1961-1973)

In the years that followed the Second World War, a large part of international trade was governed by complex national trading systems. Certain developed countries used balance of payment difficulties to justify high customs duties, complicated customs practices, complex import licence procedures and large numbers of quantitative restrictions. However, during the 50s, trade

restrictions were reduced as a result of the general liberalization efforts deployed by the GATT and the IMF.
The gradual elimination of quantitative restrictions consecutive to the attenuation of balance of payments difficulties of the developed countries coincided with the Japan's return in force to the world textile trade and the emergence of several textile exporting and, to a lesser extent at this time, clothing exporting developing countries. It was particularly the developing countries, which had access to raw materials and benefited from relatively low production costs, especially for the wage content, which started rapidly to increase the volume of their exports of textiles and clothing to the developed countries. In the developed countries, investment and employment suffered from the strong drive of imports of low value cotton textiles and production units in the sector began to dose down, provoking serious social problems. To remedy these problems, several developed countries negotiated agreements with certain countries to limit the quantity of exports of cotton textiles, and which were subsequently called "voluntary export restraint" agreements.

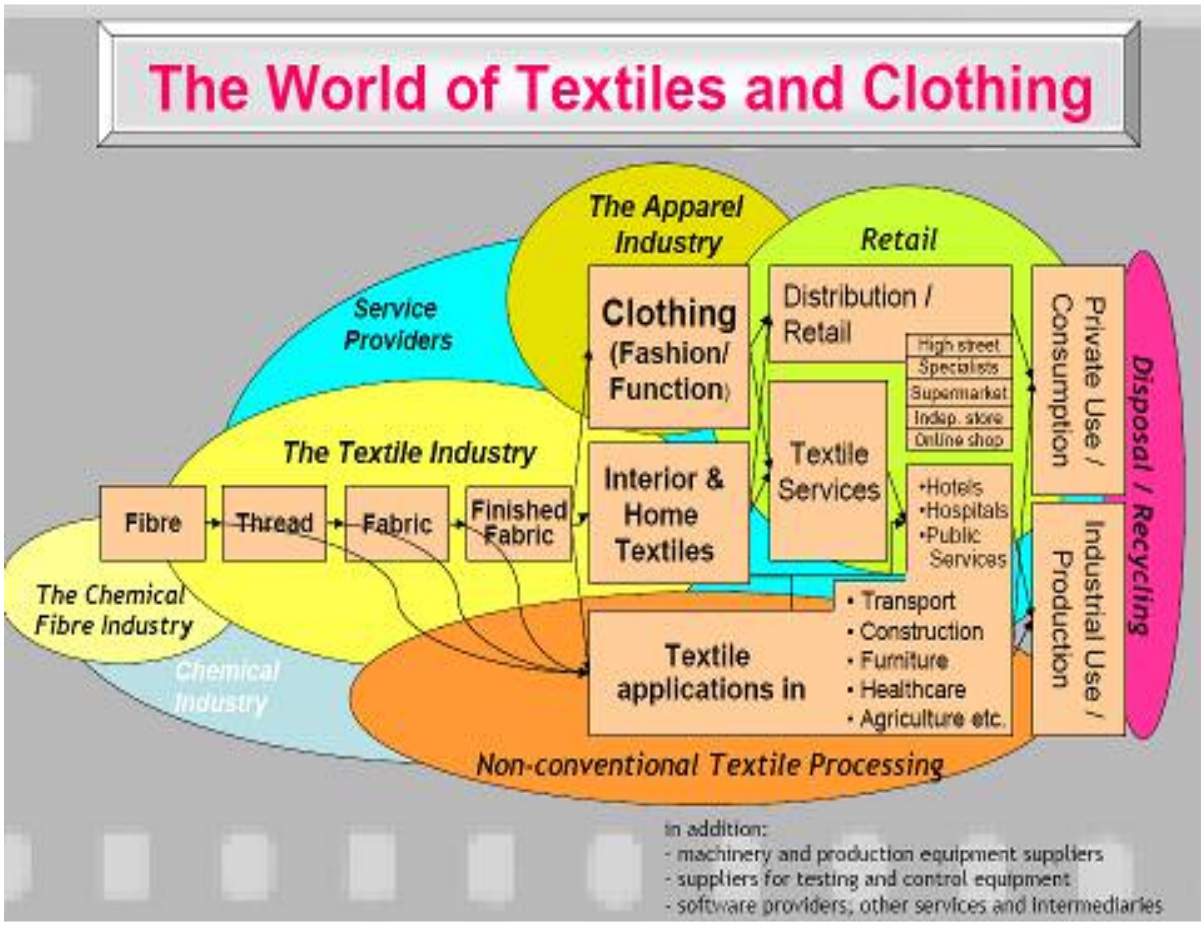
In 1959, it was proposed that the GATT proceed with a study to find a multilateral solution to the problem of the high increases in imports, over a short period and for a narrow range products, which could have serious economic, political and social repercussions in the importing countries. In 1960, the contracting parties recognized the existence of a phenomenon referred to as "market

organization", which presented the following elements in association: "
1) Imports of certain products from determined sources were growing or could grow suddenly and in substantial proportions;
2) These products were offered at prices well below those practiced on the market of the importing country for similar products of comparable quality;
3) There was a serious prejudice or the threat of a serious prejudice for national producers;
4) The price differences mentioned in paragraph 2) above were not the result of government intervention in the fixing or the forming of the prices, nor the practice of dumping.
This decision, and here was the most remarkable feature, put the accent on determined sources of supply and on the substantial competitive advantage that they presented in terms of price without there being any government intervention or dumping. The possibility of being able to take selective safeguard measures, inferred by the notion of "market disorganization", represented a fundamental infringement to the provisions of article XIX of the GATT.
4. 74. 2 - The Multi Fibre Arrangement (1974-1994)
The Multi Fibre Arrangement (MFA), whose fottiral title is the Arrangement, Regarding International Trade of Textiles, came into force in 1974. It extended the restrictions to which textiles and cotton clothing garments were already subjected, to products in wool and artificial fibres (and, from 1986, to certain vegetable fibres). Its declared objective was to "carry out, as far as textile products are concerned, an expansion in trade, a lifting of obstacles to this trade and the gradual liberalization of world trade, while ensuring the ordered and equitable development of trade in these products and by avoiding the effects of the disorganization of the markets and of types of production as much from importing countries as from exporting countries". It also had as an objective "to encourage the economic and social development of developing countries and to provide substantial growth in their income from the export of textile products, and to arrange for them to have the possibility of a larger share of the world trade in these products".
Concretely, the MFA (just as the agreements concerning cotton) provided a regulatory framework for contingents to be imposed, by means of bilateral agreements or unilateral measures when a boost in imports disorganised or threatened to disorganize the market in importing countries. At the moment of imposing contingents, the importing countries were to

respect the provisions in terms of consultations, as well as specific rules and criteria to determine whether there was market disorganization and to impose and maintain restrictions against the exporting countries. Generally, they were to provide for an annual 6% growth coefficient in the contingents. A regulatory organization, the Textiles Monitoring Body (TMB), monitored the implementation of the MEA and presented reports on the subject, and was at the same time responsible for the settlement of disputes. The MFA expired on 315{December 1994 just before the WTO started its activity, and the Agreement on Textiles and Clothing (ATC) came into force, on 1[1] January 1995.

4.75 - Evolution in the context of the MFA regime

During its 21 years existence, from *1974* to 1994, the MFA had been subjected to several operational modifications and adaptations. Several extensions had been negotiated, on which occasions new provisions had been added and new products included. Furthermore, in practice, the 6% growth coefficient of the contingent established by the MFA had often been dramatically reduced in bilateral agreements. The bilateral contingents governed by the MFA, which formed a complex network, were moreover negotiated at close intervals, often nearly every year. During the final years of the existence of the MFA, six participants (Austria, Canada, EEC, United States, Finland, and Norway) applied contingents under the MFA, which concerned different products and countries. However, apart from the restrictions concerning former State trade countries, adherents had recourse to the MFA almost exclusively to protect themselves against imports coming from developing countries. Switzerland and Japan, which were signatories 'to the MFA, did not sign limitation agreements. Sweden eliminated all the limitations that it applied and pulled out of the MFA in 1991 (the Swedish import contingents were however reintroduced once the country became a member of the European Community in 1995). In 1994, its last year of existence, the MFA had 44 participants; although this figure represented less than half the number signatories to the GATT, the majority of countries with an interest in textiles and clothing trade, were present, including China, which was not a contracting party to the GATT


The World of Textiles and Clothing
The Apparel Industry
Retail
Service Providers
Clothing (Fashion/ Function)
Distribution / Retail
High street
Specialists
Supermarket
Indep. store
Online shop
Private Use / Consumption
Disposal / Recycling
The Textile Industry
Interior & Home Textiles
Textile Services
•Hotels
•Hospitals
•Public Services
Fibre
Thread
Fabric
Finished Fabric
The Chemical Fibre Industry
Chemical Industry
Textile applications in
• Transport
• Construction
• Furniture
• Healthcare
• Agriculture etc.
Industrial Use / Production
Non-conventional Textile Processing
in addition:
- machinery and production equipment suppliers
- suppliers for testing and control equipment
- software providers, other services and intermediaries

		Total Trade				Textile Trade			
		Imports		Exports		Imports		Exports	
Reporter	Partner	1994	2001	1994	2001	1994	2001	1994	2001
Egypt	EU15	37.65	32.86	44.59	30.91	29.70	17.94	66.21	57.40
	Pan-EU	5.57	4.58	2.78	1.14	3.10	0.86	2.97	1.67
	EuroMed	2.35	3.06	13.10	13.45	5.11	5.44	6.05	2.94
	Rest of World	54.43	59.50	39.52	54.50	62.09	75.76	24.76	38.00
Israel	EU15	50.94	45.63	30.18	28.53	58.77	39.66	57.13	49.73
	Pan-EU	7.75	6.59	3.87	3.27	5.46	4.19	1.05	1.05
	EuroMed	0.81	1.01	1.02	1.69	4.71	6.26	1.13	3.56
	Rest of World	40.50	46.77	64.93	66.51	31.06	49.89	40.69	45.67
Jordan	EU15	32.85	31.42	8.61	4.87	25.48	12.14	10.17	4.87
	Pan-EU	3.92	2.87	0.74	0.74	4.46	0.45	0.48	0.07
	EuroMed	7.34	7.65	9.19	14.08	11.86	35.71	8.17	16.53
	Rest of World	55.89	58.06	81.46	80.31	58.19	51.69	81.18	78.53
Morocco	EU15	54.92	57.51	62.55	73.49	84.70	87.30	80.68	92.02
	Pan-EU	3.94	2.51	2.06	1.55	1.23	0.36	0.56	0.15
	EuroMed	3.29	3.43	4.42	1.90	2.01	1.81	3.49	0.21
	Rest of World	37.85	36.56	30.97	23.05	12.05	10.54	15.28	7.61
Tunisia	EU15	72.64	70.66	77.40	80.32	93.66	91.87	81.58	90.24
	Pan-EU	2.80	2.86	1.34	0.86	0.60	0.42	0.56	0.22
	EuroMed	3.96	3.90	5.93	3.34	0.81	1.22	1.41	0.27
	Rest of World	20.60	22.59	15.33	15.49	4.92	6.50	16.45	9.27
Turkey	EU15	45.35	48.56	48.39	52.56	31.46	47.76	62.51	63.61
	Pan-EU	5.73	5.93	5.89	5.22	2.90	2.80	7.80	5.66
	EuroMed	2.48	4.70	6.58	7.91	1.84	1.40	3.52	4.87
	Rest of World	46.44	40.82	39.14	34.31	63.80	48.03	26.18	25.87

European Union, Imports from ... Mediterranean Countries

SITC Rev.3 Product Groups	2001	%	2003	%	2005	%
TOTAL	**68 201**	**100.0**	**67 926**	**100.0**	**88 118**	**100.0**
Primary Products	**24 541**	***36.0***	**22 553**	***33.2***	**30 842**	***35.0***
of which:						
Agricultural prod.	5 509	***8.1***	5 427	***8.0***	6 674	***7.6***
Energy	17 399	***25.5***	15 615	***23.0***	22 158	***25.1***
Manuf. Products	**38 877**	***57.0***	**41 541**	***61.2***	**49 872**	***56.6***
of which:						
Machinery	7 117	***10.4***	7 594	***11.2***	9 642	***10.9***
Transport equipm	4 140	***6.1***	5 131	***7.6***	10 202	***11.6***
of which:						
Automotive prod.	2 380	***3.5***	3 649	***5.4***	6 045	***6.9***
Chemicals	3 262	***4.8***	3 152	***4.6***	3 655	***4.1***
Textiles and cloth.	15 773	***23.1***	16 842	***24.8***	16 074	***18.2***

European Union, Exports to ... Mediterranean Countries

SITC Rev.3 Product Groups	2001	%	2003	%	2005	%
TOTAL	**73 407**	**100.0**	**78 106**	**100.0**	**101 633**	**100.0**
Primary Products	**8 946**	***12.2***	**9 338**	***12.0***	**12 711**	***12.5***
of which:						
Agricultural prod.	5 601	***7.6***	5 310	***6.8***	5 813	***5.7***
Energy	1 697	***2.3***	2 022	***2.6***	4 487	***4.4***
Manuf. Products	**62 484**	***85.1***	**66 659**	***85.3***	**83 186**	***81.8***
of which:						
Machinery	20 383	***27.8***	21 079	***27.0***	26 644	***26.2***
Transport equipm	9 259	***12.6***	11 603	***14.9***	18 947	***18.6***
of which:						
Automotive prod.	6 407	***8.7***	8 597	***11.0***	12 166	***12.0***
Chemicals	10 652	***14.5***	11 915	***15.3***	14 769	***14.5***
Textiles and cloth.	6 037	***8.2***	5 735	***7.3***	5 175	***5.1***

Chapter five FDI papers and variables and models:

5. 1 - Introduction

In the 1950s and 1960s FDI and MNEs was considered by many developing countries as a menace to the national sovereignty and detrimental to the economic development.
Over the last couple of decades, the attitude towards inward foreign direct investment has changed considerably, as most countries have liberalized their policies to attract investments from foreign multinational corporations.
Since the 63000 Multinational companies are responsible to more than 80 % of world investment and more than 70 % of international trade; and at the same time the International Trade is equal to 18% of the world GDP.

And at the same time the growing of economic is guarantied by the MNCs that maintain the decision of growing, using the FDI as the mode the MNCs prefer to use when they make new investments.

That's why many researchers have made a lot of researches to better understanding the FDI effect, trend, and performance, using several variables to better explain, by empirical models, how these variables make effects on the FDI.

FDI is now considered as an important tool for economic development. This change of attitude toward FDI can be explained by many factors such a worldwide context of economic liberalisation and the pressure on LDCs to resolve their economic problems like unemployment, the lack of domestic investment ant the need to have modern technologies.

In this chapter we attempt to describe some Emperical Models, which interested about FDI and the differ effect on the economic. And host country offers a sizeable consumer market, in which case FDI serves as a substitute for commodity trade, or if growth leads to greater economies of scale and cost efficiency in the host country. On the other hand, FDI itself may contribute to host country economic growth, by augmenting the country's capital stock, introducing complementary inputs, inducing technology transfer and skill acquisition, or increasing competition in the local industry. Of course, FDI may also inhibit competition and thus hamper growth, especially if the host country government affords extra protection to foreign investors in the process of attracting their capital.

Empirically, the positive effect of host country economic growth on FDI inflow has been confirmed by various studies (see Veugelers, 1991; Barrell and Pain, 1996; Grosse and Trevino, 1996; Taylor and Sarno, 1999; Trevino et al., 2002). The effects of FDI on subsequent economic growth has been shown to be both positive (Dunning, 1993; Borensztein et al., 1998; De Mello, 1999; Ericsson and Irandoust, 2000; Trevino and Upadhyaya, 2003) and negative (Moran, 1998). Generally, the positive growth effects of FDI have been more likely when FDI is drawn into competitive markets, whereas negative effects on growth have been more likely when FDI is drawn into heavily protected industries (Encarnation and Wells, 1986). Overall, though, FDI turns out to be associated with greater domestic investment, not smaller. Moreover, this positive association between FDI and domestic investment tends to be greater than that between foreign portfolio investment and domestic investment (Bosworth and Collins, 1999).
Basu, Chakraborty and Reagle (2003) study a panel of 23 developing countries from Asia, Africa, Europe and Latin America, and find the causal relationship between GDP growth

and FDI to run both ways in more open economies, and in only one direction—from GDP growth to FDI—in more closed economies. Trevino and Upadhyaya (2003) find a comparable result, based on their study of five developing countries in Asia, that the positive impact of FDI on economic growth is greater in more open economies. Whether other factors, especially institutional ones that directly affect FDI or economic growth, also influence FDI-growth relationship remains an open question.
Generally speaking, FDI decisions depend on a variety of characteristics of the host economy, in addition to its market size. These include the general wage level, level of education, institutional environment, tax laws, and overall macroeconomic and political environment. The impact of host country wage level or education level on FDI depends on the skill intensity of the particular production process in question and, hence, may vary from case to case. The impact of institutional quality, physical infrastructure, import tariffs, macroeconomic stability, and political stability on FDI inflow is usually positive (Wei, 1997; Mallampally and Sauvant, 1999; Trevino et al., 2002; Biswas, 2002), whereas that of corporate taxes tends to be negative (see Wei, 1997; Gastanaga et al., 1998; Hsiao, 2001). Turning to economic growth, the standard determinants include the rate of capital accumulation and variables that raise total factor productivity, such as education level, institutional quality, macroeconomic stability, political environment, and, potentially, trade openness.

5. 2 INSTITUTIONAL FACTORS AFFECTING THE FDI-GROWTH RELATIONSHIP

Most studies investigating the causes of FDI or economic growth concentrate on identifying factors that directly affect the variable under consideration. In this sense, the analysis in the preceding section, which tests for a direct, causal relationship between FDI and growth, is similar to existing studies. The key finding from the causality tests here that is of particular significance is the cross-country variation in FDI-growth causality. Some of this variation is likely due to cross-country differences in the predominant type of FDI inflow, that is, the investor's motivation behind FDI, such as access to host country consumer markets versus locating low-cost production areas. Additional variation in the FDI-growth causal relationship likely arises from cross-country differences in economic and institutional structures. Very few studies have explored these host country influences. Examples include Basu et al. (2003) and Trevino and Upadhyaya (2003), both of which find that the degree of trade openness of the host country affects the extent to which growth and FDI affect each other. We extend this line of work by considering a broader set of economic and institutional factors, and attempt to better understand the variation in FDI-growth causalities observed within our sample.

A causal link from FDI to economic growth seems more likely to exist in countries that receive less FDI, are less open, have more limited transparency and rule of law, receive greater amounts of aid from the U.S., and have lower income per capita. On the other hand, growth-to-FDI causality is more likely in countries that have greater political rights and receive smaller amounts of bilateral aid overall. Of course, this cursory glance misses valuable information contained in the time-series variation within the panel data, and is therefore only suggestive

It is plausible that due to structural reasons foreign investment has a greater degree of immunity to domestic corruption and institutional weaknesses than does domestic

investment, and consequently the marginal productivity of foreign capital is relatively higher in an environment with weaker legal infrastructure. In this sense, FDI and domestic rule of law exhibit some substitutability in generating domestic economic growth. Finally, note that the negative interaction effects associated with bilateral aid receipts and income level are consistent with diminishing returns to resources.
Turning to the FDI model, the positive and significant effect of economic growth on subsequent FDI inflow is found to be greater in the presence of greater political rights (lower PR index) and more limited rule of law in the host country. Note, however, that the direct effect of political rights on FDI inflows is negative, and that of domestic rule of law is positive. This suggests that in the sample region FDI as a whole has been more likely in the presence of more authoritarian regimes, perhaps reflecting greater stability, whereas market-seeking FDI, which is induced by growth, prefers political competition in the host country. Similarly, well-functioning institutions and legal systems attract FDI overall, but in the presence of institutional weakness, the pull effect of economic growth on FDI inflow tends to be greater. Weak institutions and economic growth thus exhibit some substitutability in inducing FDI, and it may be that institutional weakness is more harmful to domestic investment than it is to foreign investment and, consequently, growth induces greater FDI when domestic institutions are weak.

5.3 - Problems with Research Results and Data
Data on many countries is lacking, obsolescent, or inaccurate and the reasons for inaccuracies:
- Inability of governments to collect data
- Educational qualifications of government officials limit collection and analysis of data
- Economic factors hamper retrieval and analysis
- Publication of false or purposely misleading data

People's desire and ability to cover up data on themselves

5.4 - Comparability problems
Problems with information comparability arise from:
Differences in collections methods, definitions, and base years, accounting rules differ and variance in measures of investment flow, differences in activities taking place outside the market economy, distortions in currency conversions, exchange rates

5.5 - External Sources of Information
Individualized reports: consultants conduct studies for a fee
Specialized studies: research organizations prepare specific studies that are sold to interested firms
Service companies: published reports of firms that provide services to international clients
Reports usually lack specificity
Governmental agencies: statistical reports on a variety of topics
International organizations and agencies: have large research staffs that compile data and publish reports and recommendations
Trade associations: publish data on technical and competitive factors for a specific industry
Information service companies : maintain data bases
The Internet: information expanding rapidly, Concerns about reliability of the information

5.6 - Internal Generation of Data
MNEs may have to conduct studies, May simply involve being observant and asking questions

5.7 - Country Comparison Tools: Used for narrowing alternatives and allocating operational emphasis among countries.

5. 8 - Grids: tools that May depict acceptable or unacceptable conditions and Rank countries by important variables

Some examples about variables which used to valuate the FDI degree:	
R&D	total R&D expenditures / GDP;
Education level	school enrolment in tertiary education / total enrolment
Openness economy	exports and imports of goods and services / GDP
Market share	GDP country / World GDP
Growth	GDP annual variation

5.9 - FDI AND GROWTH IN THE MEDITERRANEAN: ESTIMATION WITH A STRUCTURAL MODEL.

Like many other developing countries, Southern Mediterranean Countries have made the remarkable transformation from being hostile to foreign direct investment in the 1970s to eagerly attracting multinational firms.

Although having real advantages such as their geographical proximity to the European Union and a relatively cheap labour cost, the economies of the South shore of Mediterranean are excluded from the surge of FDI toward the emerging countries.
It's interesting to sea how the foreign direct investment has contributed to the economic growth of Mediterranean LDCs.

The proposal can be justified by the important potential effect of FDI on host economies such as described by many scholars and empirical studies about this topic. In fact for the vast majority of politicians, international institutions, and economists, FDI appears to be a sort of panacea for every economic problem. Its positive impact on economic growth has acquired the status of conventional fact. The almost desperate effort efforts of many countries to attract as much FDI as possible indirectly support this point of view.
The advanced general argument is that the FDI can contribute to the economic development thanks to the spillovers effects which occur through the development of human and physical capital, the intensification of international trade and the transfer of technology

5. 10 - Theoretical FDI spillover effects:

stock of human capital, propension to invest, per capita income, Carkovic and Levine (2002): "While there are sound conceptual reasons for believing that FDI can ignite economic growth, the empirical evidence is divided"
FDI-growth: Macroeconomic analyses, Prevailing literature: positive relationship between FDI and growth, Borensztein et al. (1995) – set of 69 developing countries receiving flows from industrialized countries, Balasubramanyam et al. (1999) – Asian and South American countries. Alfaro et al. (2000) – three samples of countries, ranging from developing to advanced Berthélemy and Démurger (2000) – Chinese provinces, Nair-Reichert and Weinhold (2001) – sample of 24 developing countries.
Notarstefano and Scuderi (2004) – EMP countries. Carkovic and Levine (2002) they criticise methodologies employed by macroeconomic approaches, which often do not control for simultaneity distortions and specific country effects.
Dynamic panel estimation on a set of countries, ranging from developing to advanced. FDI are found to be not related with growth

Microeconomic analyses at firm level, Positive spillover effects of FDI, Liu (2002), manufacturing Chinese industries. Branstetter (2006) – Japanese firms investing to the US Absence of spillover effects. Aitken and Harrison (1999) – firms in Venezuela
see also Germidis (1977), Haddad and Harrison (1993), Mansfield and Romeo (1980)
Why has MENA trade not been thoroughly investigated as a slow-growth determinant? JEFFREY B. NUGENT. Evidence: Although still controversial, important evidence that trade growth is causal to income growth (Frankel & Romer 1999). Growth has lagged in MENA at least until the exploding oil prices of the last two years. Could slow trade growth contribute to this?
Other, possibly potentially more important, slow-growth determinants have been investigated.
Role of institutions (Elbadawi 2005 , Kuran 2004) Human Capital Formation (UNDP 2003,2004, Pritchett, 1996) High fertility rates and rapid population growth. (Williamson and Yousef 2002). Inflexible labor market institutions (Pissarides and Vergazones-Varoudakis 2006, Campos, Hsiao and Nugent 2005).

5. 11 - Capital accumulation

The presence of numerous methodological difficulties that may have discouraged empirical investigations of both the determinants of trade and its effects on growth. a. Problems of measurement of trade policy. b. Traditional measurement OPENNESS is an outcome variable (interdependence between trade and trade policy and economic growth. c.Frankel & Romer 1999's innovation.
Effects of trade on growth have sometimes been found to be considerably weaker for MENA countries than for other countries. (Makdisi, Fattah and Limam 2005)
The most common measure of openness (X+M)/GDP is often unusually large for MENA countries leading to conclusion that MENA countries do not trade too little.

Activity	Positive Spillover Effects
Human Resources Development Training in foreign affiliates. Training rendered to personnal in linkage activities. . Financial contributions to Education Institutions. **Health and Nutrition** Investment in health and nutrition activities. **Technology Transfer** Transfert of most recent technology to affiliates. Importation of new capital goods and equipment. Introduction of R&D in overseas subsidiaries. Selling or licensing old technology. A Technical assistance rendered to suppliers and consumers in linkage activities.	Raises productivity by increasing capability to accept and adopt new technology and knowledge. Acquisition of skills – increases productivity and average level of skills of country. Facilitates the diffusion of technology. Facilitates the transfer of foreign management methods and worker discipline. Promote entrepreneurship. Improves efficiency of labour-intensive process. Transfers technology to host country. Improves product quality and range; and production process and hence factor productivity by lowering unit costs.Induces competition, encouraging local firms to increase R&D and therefore innovation.

Activity	Positive Spillover Effects
Capital Formation * Investing retained earnings. * Payement of taxes, contractuel fees. *Indirect contribution through linkage activities. - Tax payment by suppliers. **International Trade** *Involvment in international trade - Imports of parts of components from investing countries. - Exports of finished products to investing countries and third- country market. . *Provision of marketing, distribution, product design, quality standard, brand name use, etc.	*Increases quality and quantity of host country's stock of physical capital. * Increases ratio of investment/GDP * Increases competition and therefore efficiency of investment. *Stimulates local investment by buying locally. *Increases international trade by providing opportunities to expand and improve production of goods and services. *Increases demand for host country's products. *Increases competition and hence promotes innovation and product quality. *Eases supply contraints of host country. *Exposes exporting firms to international techniques in marketing, processing and other information.

The spillover effects of FDI are interlinked, complementary and cannot possibly be iscussed separately. The interaction is such that gains in one factor may stimulate improvement in one or more of the others, thus magnifying the stimulus or forming a synergy
Presentation of new the model .

Gr = ***f*** (FDI, **KH**, **EXPORT**, **DI)**	Economic Growth [eq.1]
DI = ***f***(G**r,FDI,** CREDIT**,** INTEREST, DS)	Domestic Investment (DI) [eq.2]
EXPORT=***f***(FDI, XR,Btrade)	[eq.3]
KH=*f* (FDI, GE, Urban, TEL	Human Capital (KH) [eq.4]
FDI = ***f*** (**Cr**, ENERGY, KH, OPEN, REM)	Foreign Direct Investment (FDI) [eq.5]

Endogenous variables

Gr: Growth rate of real GDP per capita.
DI: Annual percentage ratio of gross fixed capital formation to GDP.
EXPORT: Total annual exports of goods and services as a percentage ratio of GDP.
FDI: Annual percentage ratio of FDI to GDP.
KH: School enrolment, secondary (% gross).

Model Result: Division of the sample in three “homogeneous " groups.
G1: Morocco, Tunisia, and Turkey.
G2 : Algeria and Egypt.
G3: the third group is formed by Jordan and Syria.
Two- stage least squares (2SLS) estimation technique has been employed using the panel data from 1975- 2002 for each country’s group and the selection of fixed effect model.

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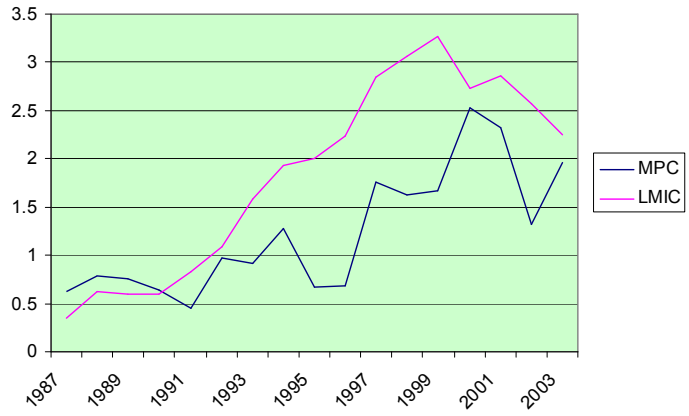
5.12 - FDI-growth: Review

Foreign debt crisis of developing countries (Eighties)
Attention to no debt creating flows like FDI
Many countries offered tax incentives and subsidies to attract foreign capital
FDI nowadays accounts for over 60 percent of private capital flows
Increase of FDI towards Mediterranean developing countries (DCs) has been considerably smaller than the one shown by all the DCs



FDI/GDP ratio
LMIC = Low and Middle Income Countries
MPC = Mediterranean Partner Countries

5.13 - FDI-growth: Review

Advantages of Gravity Models: can be derived from underlying microeconomic foundations (Bergstrand, 1985), less subject to simultaneous and omitted variable biases as compared to the other two models.Use much more reliable databases than CGE models.
Results shown to be quite robust to different specifications, modeling assumptions and data sets and applicable to all kinds of countries and time periods (Leamer and Levinsohn, 1995)
Qualifications (Anderson and Van Wincoop) can be mitigated by Including Broad range of size and other controls and Fixed effects

5.14 - Gravity Models and MENA Trade

Applications to MENA region are relatively rare.

Ekholm et al. (1996): Low potential for trade growth both within MENA and with EU. (May have discouraged further investigations in MENA).

Limitations of Study: Small sample of countries: 13 DCs and 11 LDCs for one year. Small number of variables included.

Findings Counterintuitive and inconsistent with most other studies. Hence, results could be misleading. Other Studies: Al-Atrash and Yousef (2000). Miniesy, Nugent (2005), Miniesy, Nugent and Yousef (2004)

5.15 - Trade Policy recommendations

Improve internal transport and communications infrastructure

Simplify and improve customs procedures at the borders so that having common border with a trading partner would exert a stronger positive influence on trade of MENA than at present.

Reduce the likelihood and strength of civil and international conflicts that exert rather sizable negative influences on trade; Increase financial depth measured by M2/GDP.

Promote greater and better implemented trade pacts with both MENA and non-MENA countries.

Improve compliance with agreements with penalties for non-compliance.

Improve governance in MENA countries and choose partners with better governance and at same levels of per capita income.

EU should impose stricter time limits on MENA for homogenizing policies and institutions.

5.16 - Trade and Foreign Exchange Liberalization

Empirical studies differ with respect to FDI specifications. The differences concern both the variables to be included in the specification and their definition (nominal versus real measures and levels versus growth rates). A common specification relates nominal FDI to GDP, per capita GDP and the growth rate of GDP (see UNCTAD, 1998). Here, we adopt this basic specification to which we add indicators of trade and foreign exchange liberalization:

$$\text{Log}(FDI) = \alpha_0 + \alpha_1 \log(GDP) + \alpha_2 \log(GDPpc) + \alpha_3 RGDP + \alpha_4 Lib + \mu \qquad (1)$$

With

FDI:	nominal FDI
GDP:	nominal GDP of the host country
GDPpc:	real per capita GDP
RGDP:	real GDP growth rate of the host country
Lib:	trade and foreign exchange liberalization indicator
μ:	error term.

GDP captures the size of the host country's internal market.

A higher GDP is assumed to imply better market opportunity and more attractiveness for FDI $(\alpha_1 > 0)$.

GDPpc is related to the wealth of the resident of the host country and then to demand effectiveness. A higher real GDP per capita is also supposed to increase the attractiveness for FDI $(\alpha_2 > 0)$.

The *RGDP* reflects the dynamism of the host country and its future market size.

An increase in the growth rate of real GDP characterizes a dynamic economy which may be more attractive for investors $(\alpha_3 > 0)$.

, we expect trade and foreign exchange liberalization to participate in a friendly climate for business and investment and to lead to more FDI inflows $(\alpha_4 > 0)$. A synthetic indicator of trade and foreign exchange liberalization is provided by Sachs and Warner (1995).

This is a dummy variable (*S-W*) taking the value one for the years during which a country was classified as liberalized and the value zero otherwise.

A country is classified as liberalized according to the following criteria:

(a) Non-tariff barriers covering less than 40 percent of traded goods,

(b) Average tariff rates below 40 percent,

(c) a BMP of less than 20 percent,

(d) No extreme controls in the form of taxes, quotas or state monopolies on exports and

(e) The country is not considered a socialist country.

Equation (1) was first estimated using the above indicator (*S-W*). We, then, split this indicator into four components: one concerns openness to trade and the others concern foreign exchange market.

Trade openness: measured as the ratio of trade to GDP has been used extensively in the literature. This ratio is not appropriate for the case of MENA countries. Several MENA countries have high trade ratios reflecting partly the nature of their factor endowment (oil in particular). We therefore use an indicator which correct for this bias. The indicator chosen is calculated as the ratio of imports plus exports to GDP from which we have deducted the "Natural Trade Openness" of the economies calculated by Frankel and Romer (1999), as well as the exports of oil and mining products. This indicator reflects better the trade policy (*TPol*) of a country than the simple trade openness ratio

Regarding exchange market, we use the dollar real exchange (*RER*), its volatility (*RERVol*) and the Black Market Premium (*BMP*). The latter — which is a widely used measure of distortion in foreign exchange market — as well as RER volatility and appreciation are expected to affect negatively FDI flows.

$$Log(FDI) = \alpha_0 + \alpha_1 \log(GDP) + \alpha_2 \log(GDPpc) + \alpha_3 (RGDP) + \alpha_4 \log(TPol) + \alpha_5 \log(RER) + \alpha_6 \log((RERVol) + \alpha_7 \log(BMP) + \mu \quad (1')$$

Equations (1) and (1') were estimated using a sample of cross-section and time series data. The sample includes annual data from 1990 to 1999 and covers 48 to 72 countries (excluding OECD and East European countries, see *Annex* 1 for the list of countries). We used panel data econometric methodology. Tests of fixed and random effects were conducted to select the most adequate models. The estimates are heteroskedastic consistent.

5-17 - Investment Climate

The above results lend clear support to the positive impact of trade and foreign exchange liberalization on total FDI inflows. However, international evidence (see Dasgupta et al, 2002) suggests that companion policies aiming at strengthening the investment climate would be needed to further increase the attractiveness of a country.

To disentangle the role of the various determinants, we augmented and re-estimated equation 1 with indicators of infrastructure availability, economic and political stability. Given the reported strong complementarily between FDI and human capital (Borensztein et al, 1998) an indicator of the availability of adequate human capital is also considered. The indicators were first introduced separately and then simultaneously (see Equation (2)).

We used the aggregate Sachs and Warner (1995) index of trade and foreign exchange liberalization (*S-W*) and did not use a similar split as in Table 1. Otherwise — given the missing observation for exchange rate variables (*RER* and *RERVol*) and *BMP* on the one hand and those for the additional variables on the other hand — we would have ended-up with a very limited number of observations.

As an indicator of human capital we used the secondary school enrolment ratio (*Enrol2*). The number of fixed phones per capita proxies the availability of infrastructure (*Phone*).

The indicators of economic and political stability were drawn from the International Country Risk Guide (1999) where a numerical value is assigned to a predetermined range of risk components The scale awards the highest value to the lowest risk and the lowest value to the highest risk. The economic risk rating (*EcoStab*) provides an assessment of a country's current economic strengths and weaknesses[7] while the aim of the political risk rating (*PolStab*) is to provide a mean of assessing the political and institutional framework of the countries[8] (see ICRG, 1999).

$$Log(FDI) = \alpha_0 + \alpha_1 \log(GDP) + \alpha_2 \log(GDPpc) + \alpha_3 (RGDP) + \alpha_4 (S-W) + \alpha_5 \log(Enrol2) + \alpha_6 \log(Phone) + \alpha_7 (EcoStab) + \alpha_8 (PolStab) + \mu \quad (2)$$

At this stage of the empirical analysis, we can conclude that the impact of trade and foreign exchange liberalization is robust and consistent across specifications. This impact is rather strong: one standard deviation of the *S-W* indicator leads to an increase of 0.2 point of the log of FDI. The results also confirm that a friendly business climate complements trade and foreign exchange reform in further attracting FDI9. For instance, one standard deviation improvement of physical infrastructures leads to an increase of 0.11 point of the log of FDI

[7] The economic risk rating includes: GDP per capita, real GDP growth, annual inflation rate, budget and current account balance as percentage of GDP.

[8] The political risk index is composed of 12 indicators: government stability, socioeconomic conditions, investment profile, internal and external conflicts, corruption, military in politics, religion in politics, law and order, ethnic tensions, democratic accountability, bureaucratic quality.

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5. 18 - FDI in Manufacturing

In the previous section, we have empirically validated the positive role of trade and foreign exchange liberalization, as well as of the investment climate on total FDI flows to the developing world. FDI in manufacturing being more productive than total FDI, it is interesting to ask the question of its determinants.

In this section, we have investigated if trade and foreign exchange liberalization, as well as the investment climate have constituted pertinent explanatory factors of the attractiveness of a country in terms of FDI flows to the manufacturing industry. Equation (2) has been tested by replacing total FDI by FDI in manufacturing.

The equation has been estimated using a sample of 20 to 26 countries from 1990 to Due to the lack of information on FDI in manufacturing; our sample has been substantially reduced. As before, we used panel data econometric techniques.

Another important finding consists in the magnitude of the coefficient of the liberalization index. This coefficient is almost double than in the case of total FDI This makes trade and foreign exchange liberalization an even more important factor for the attractiveness of a country when more productive FDI is concerned. This can be justified by the fact that trade and foreign exchange liberalization introduces more competition, provides more market opportunities and allows for more technology transfers. These conditions can be considered as good incentives for the manufacturing sector to invest — especially when export oriented.

When additional determinants of FDI are introduced separately in the equation (i.e. human capital (*Enrol2*), fixed phones (*Phone*), political (*PolStab*) and economic stability (*EcoStab*)), their coefficients have the expected positive sign but are not always significant. This is the case of education (*Enrol2*) and of economic stability (*EcoStab*). When these indicators are introduced simultaneously, only the coefficient of political stability (*PolStab*) remains significant.

In summary, the estimation of the determinants of FDI in the manufacturing industry has revealed to be more difficult than the one of total FDI. Some results seem, however, robust. This is the case of the size of the market (which gives to the foreign investors a positive signal to invest in a country), of trade and foreign exchange liberalization (which impact on FDI flows is always significant), as well as of political stability. These are interesting findings which should not be neglected if a country wants to attract more productive FDI.

Other factors — such as education, core infrastructure or macroeconomic condition — could also have played a significant role in attracting more productive FDI. The small size of our sample however — when focusing on FDI in the manufacturing industry — must explain the difficulties in estimation. These factors should, nevertheless, be considered carefully when implementing the reform agenda of the MENA countries.

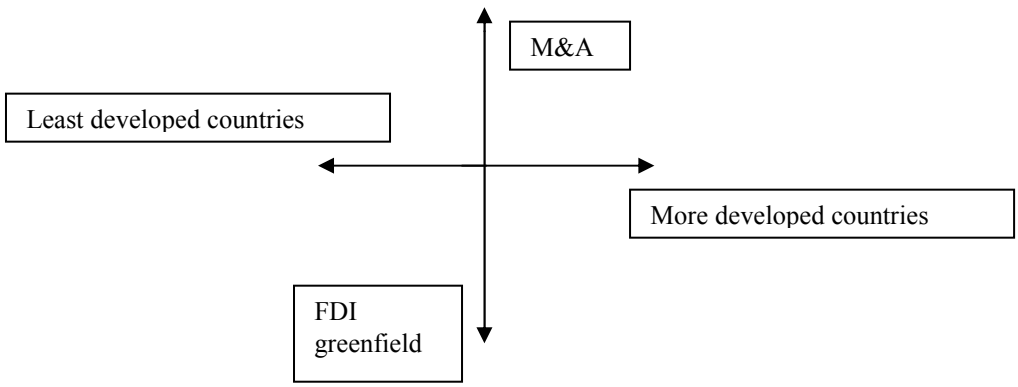
. Summary of variables

Variable	Definition	Source
FK	Foreign Direct Investment as percentage of the GDP	UNCTAD, FDI database
FP	Foreign presence	UNCTAD, FDI database
Human capital	School enrolment in tertiary education (%Total)	World Development Indicators 2005
Openess	Exports and imports of goods and services (%GDP)	World Development Indicators 2005
R&D	Research and Development expenditures (%GDP)	World Development Indicators 2005
Market Share	Share of the world GDP accounted by country i	World Development Indicators 2005
Growth	Annual variation of GDP	World Development Indicators 2005

Table 2: Summary of rank correlations – FDI and national factors

	Foreign capital (FDI intensity)	**Foreign Presence (Cross border M&A weight)**
Total World	FP; Open	FK; Human capial R&D; Open
High income	FP; Open	FK
Upper-middle income	FP; Market	FK; R&D
Low-middle income	FP; Growth (-)	FK
Low income	FP; Open	FK

Development and type of FDI



5- 19 - GRANGER CAUSALITY

In order to test for direct causality between FDI and economic growth, we perform a Granger causality test using equations (1) and (2):

$$GDP_t = \gamma + \sum_{i=1}^{k} \alpha_i \cdot GDP_{t-i} + \sum_{i=1}^{k} \beta_i \cdot FDI_{t-i} + \mu_t \qquad (1)$$

$$FDI_t = \phi + \sum_{i=1}^{k} \delta_i \cdot GDP_{t-i} + \sum_{i=1}^{k} \lambda_i \cdot FDI_{t-i} + \eta_t \qquad (2)$$

where GDP_t and FDI_t are stationary time series sequences, γ and ϕ are the respective intercepts, μ_t and η_t are white noise error terms, and k is the maximum lag length used in each time series. The optimum lag length is identified using Hsiao's (1981) sequential procedure, which is based on Granger's definition of causality and Akaike's (1969, 1970) minimum final prediction error criterion. If in equation (1) $\sum_{i=1}^{k} \beta_i$ is significantly different from zero, then we conclude that FDI Granger causes GDP. Separately, if $\sum_{i=1}^{k} \delta_i$ in equation (2) is significantly different from zero, then we conclude that GDP Granger causes FDI. Granger causality in both directions is, of course, a possibility.

Since macroeconomic time-series data are usually non-stationary (Nelson and Plosser, 1982) and thus conducive to spurious regression, we test for stationarity of the data series before proceeding with the Granger causality test. We employ two separate methods for the stationarity test. First, we conduct an augmented Dickey-Fuller test (Nelson and Plosser, 1982) by carrying out a unit root test based on the structure in (3):

$$\Delta X_t = \kappa + \rho \cdot t + \theta_i \cdot X_{t-i} + \sum_{i=1}^{n} \varphi_i \cdot \Delta X_{t-i} + \varepsilon_t \qquad (3)$$

Where X is the variable under consideration, Δ is the first difference operator, t captures any time trend, ε_t is a random error, and n is the maximum lag length.

The optimal lag length is identified so as to ensure that the error term is white noise. If we cannot reject the null hypothesis $\theta = 0$, then we conclude that the series under consideration has a unit root and is therefore non-stationary. Second, in addition to the Dickey-Fuller test, we perform the Phillips-Perron test (Phillips, 1987; Phillips-Perron, 1988), using a non-parametric correction to deal with any correlation in error terms.

5-20 - Institutional factors affecting the FDI – Growing relationship

Most studies investigating the causes of FDI or economic growth concentrate on identifying factors that directly affect the variable under consideration. In this sense, the analysis in the preceding section, which tests for a direct, causal relationship between FDI and growth, is similar to existing studies. The key finding from the causality tests here that is of particular significance is the cross-country variation in FDI-growth causality. Some of this variation is likely due to cross-country differences in the predominant type of FDI inflow, that is, the investor's motivation behind FDI, such as access to host country consumer markets *versus* locating low-cost production areas. Additional variation in the FDI-growth causal relationship likely arises from cross-country differences in economic and institutional structures. Very few studies have explored these host country influences. Examples include Basu et al. (2003) and Trevino and Upadhyaya (2003), both of which find that the degree of trade openness of the host country affects the extent to which growth and FDI affect each

other. We extend this line of work by considering a broader set of economic and institutional factors, and attempt to better understand the variation in FDI-growth causalities observed within our sample.

Notes:
'0' for FDI → GDP or GDP → FDI denotes the absence of the corresponding granger causality.
'1' for FDI → GDP or GDP → FDI denotes the presence of the corresponding granger causality.
GDP-PC refers to per capita GDP, measured at purchasing power parity exchange rates.

Political rights index is based on Freedom House reports, with lower values reflecting more freedom.

In results, divide the sample countries into four sub-groups, based on the existence of causal relationships between FDI and growth, and present a set of economic and institutional data for each sub-group. A glance at these data, though cursory, is somewhat revealing.
A causal link from FDI to economic growth seems more likely to exist in countries that receive less FDI, are less open, have more limited transparency and rule of law, receive greater amounts of aid from the U.S., and have lower income per capita. On the other hand, growth-to-FDI causality is more likely in countries that have greater political rights and receive smaller amounts of bilateral aid overall. Of course, this cursory glance misses valuable information contained in the time-series variation within the panel data, and is therefore only suggestive. In order to draw more accurate inferences from the given data, we use basic regression techniques and look at the interaction effects associated with the FDI-growth relationship.
For the sample as a whole, the effect of FDI on subsequent economic growth is not statistically significant , whereas the effect of growth on subsequent FDI inflow is positive and significant.
It is worth noting, though, that inclusion of country dummies in the growth model reveals the growth effect of FDI to be positive, diminishing, and statistically significant. More central to our analysis here are the interaction effects in the two models. In this context, the growth model reveals that the effect of FDI on economic growth is more positive in countries characterized by *greater* trade openness, more limited rule of law, *lower* receipts of bilateral aid, and lower income level. The positive effect of openness on FDI-to-growth causality is consistent with the findings by Basu et al. (2003) and Trevino and Upadhyaya (2003), and likely reflects the importance of an open, competitive economic environment required for productive investment. The negative interaction effect of the rule of law, in our interpretation, is suggestive of a beneficial role of FDI within an institutional environment that otherwise constrains the efficiency of investments.

It is plausible that due to structural reasons foreign investment has a greater degree of immunity to domestic corruption and institutional weaknesses than does domestic investment, and consequently the marginal productivity of foreign capital is relatively higher in an environment with weaker legal infrastructure. In this sense, FDI and domestic rule of law exhibit some substitutability in generating domestic economic growth. Finally, note that the negative interaction effects associated with bilateral aid receipts and income level are consistent with diminishing returns to resources.

Turning to the FDI model, the positive and significant effect of economic growth on subsequent FDI inflow is found to be greater in the presence of greater political rights (lower PR index) and more limited rule of law in the host country. Note, however, that the direct effect of political rights on FDI inflows is negative, and that of domestic rule of law is positive. This suggests that in the sample region FDI as a whole has been more likely in the presence of more authoritarian regimes, perhaps reflecting greater stability, whereas market-seeking FDI, which is induced by growth, prefers political competition in the host country. Similarly, well-functioning institutions and legal systems attract FDI overall, but in the presence of institutional weakness, the pull effect of economic growth on FDI inflow tends to be greater. Weak institutions and economic growth thus exhibit some substitutability in inducing FDI, and it may be that institutional weakness is more harmful to domestic investment than it is to foreign investment and, consequently, growth induces greater FDI when domestic institutions are weak.

Governance measures are two indicators of democracy: Polity IV, Freedom House: political rights and civil liberties
Governance indicators: IRCG, Quality of bureaucracy, Corruption, Law and order, An overall governance indicator.

5-21 - The overall impact of EU-MED agreements

$$y_{it} = a_i + \sum \phi_t T_t + \sum \alpha_m x_{m,it} + \delta Euromed_{it} + e_{it}$$

Yit is governance in country *i* at time t,
ai is a time-invariant effect unique to individual *i*
it is time effect common to all countries at time t,
Xit is a set of other control variables,
Euromedit is a binary Euro-Med membership indicator; it takes the value of 1 from the year the agreement was signed and 0 otherwise
eit is an unobserved error term

The timing in the effects

$$y_{it} = a_i + \sum \phi_t T_t + \sum \alpha_m x_{m,it}$$
$$+ \delta_1 Euromed(-2)_{it} + \delta_2 Euromed13_{it} + \delta_3 Euromed >= 4_{it} + e_{it}$$

yit, ai, Tt, xit, eit are defined in the same way as in equation (1) ;

*Euromed(-2)*it is a dummy variable that takes the value of one the two years before the agreement was signed, and zero otherwise;
*Euromed13*it equals to one the year when the agreement was signed and the two following years;
Euromed>=4 it equals to 1 from the 4th year after the agreement was signed.

Two estimations techniques
Within comparisons: only use the time variation in the data. It consists in estimating equation (1) and (2) on a sample made only with countries that have signed an agreement.

Difference-in-differences estimations (DID): consist in identifying a specific intervention or treatment. One then compare the difference in a dependent variable before and after the intervention for groups affected by the treatment to the same difference for unaffected groups.

Concluding remarks:
- A strong positive effect on the quality of the judicial system.
- The impact on the overall governance is less clear-cut.
- No effect on the respect of democratic principles.

Several reasons can explain this lack of results:
EU-MED agreements are still recent the threat of sanctions by the EU is not credible
The weakness of the resources dedicated to democratization
Our analysis must be extended to all Trade Agreements the European Community has ratified.

5-22 - The UNCTAD Inward FDI Performance Index Model.

$$INDi = \frac{FDI_i / FDI_w}{GDP_i / GDP_w}$$

INDi= The Inward FDI Performance Index of the "*i*" country
FDIi= FDI inflows in the "*i"* country
FDIw = World FDI inflows
GDPi = GDP in the "*i*"country
GDPw = World GDP.
The UNCTAD Inward FDI Potential Index is the ***unweighted average*** of the scores on twelve variables (Independent Variables) for each country.

Quantitative Determinant used in Potential Index	**Proxy of Determinants**
GDP per capita	Level of economic development
The rate of GDP growth over the previous 10 years	Size of a host-country market
The share of exports in GDP	Openness
Telecoms infrastructure (the average of telephone lines per 1,000 inhabitants, and mobile phones per 1,000 inhabitants)	Modern information and communication infrastructure
Commercial energy use per capita	Availability and cost of energy
The share of R&D expenditures in gross national income	Technological capabilities
The share of tertiary students in the population	Extent of higher education and related skills that a country's workforce embodies
Country risk	Political and commercial risk
Exports of natural resources as a percentage of the world total	Availability of natural resources
Imports of parts and components of electronics and automobiles as a percentage of the world total	Participation in the leading TNC integrated production systems
Exports in services as a percentage of the world total	Importance of FDI in the services sector
Inward FDI stock as a percentage of the world total	Investment climate

Then when each country's scores multiplied with these weights, new weighted country FDI Attractiveness scores are achieved. This table shows the rankings of EU-25 countries' established with both weighted and unweighted variables. As you see in the table' most of the countries rankings changes.

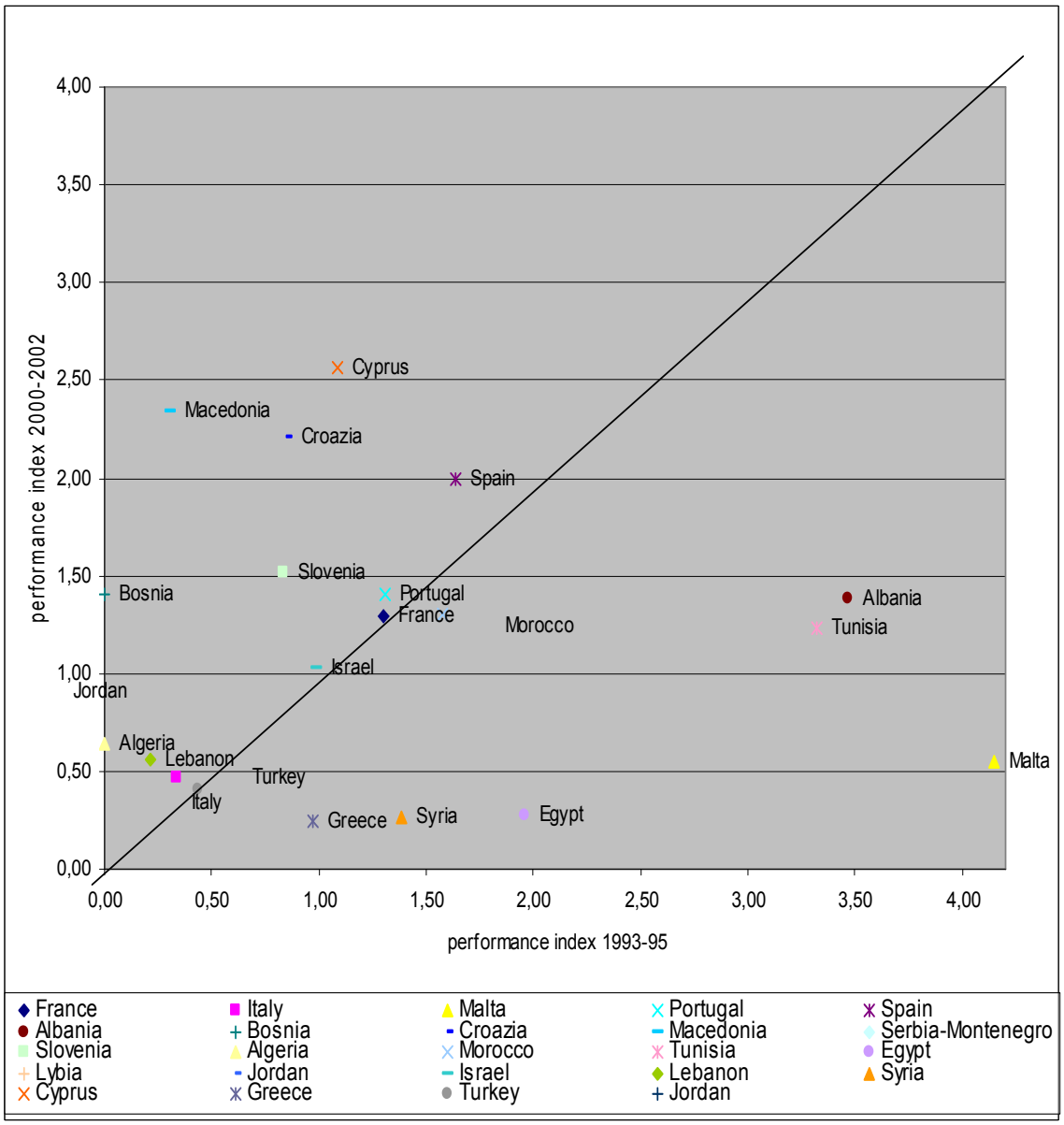
	Country	UNCTAD Inward FDI Potential Index Rank	
		Unweighted	Weighted
EU-25	United Kingdom	3	2
	France	12	3
	Germany	8	6
	Ireland	10	8
	Netherlands	11	9
	Belgium and Luxembourg	9	11
	Austria	19	12
	Italy	26	16
	Spain	25	17
	Sweden	6	18
	Finland	13	21
	Denmark	18	24
	Slovenia	28	31
	Estonia	32	33
	Greece	33	36
	Poland	43	37
	Portugal	36	40
	Latvia	44	41
	Hungary	40	43
	Cyprus	42	46
	Lithuania	47	47
	Slovakia	46	48
	Malta	37	51
	Czech Republic	39	54
Developed	Norway	2	5
	Iceland	14	19
	Switzerland	17	23
Acceding	Bulgaria	61	93
	Romania	81	108
Candidate	Croatia	49	57
	Turkey	72	80
Potential Candidate	Albania	80	73
Other Mediterranean	Israel	23	30
	Libyan Arab Jamahiriya	34	39
	Egypt	75	58
	Algeria	71	61
	Tunisia	67	66
	Lebanon	64	82
	Syrian Arab Rep.	95	90
	Morocco	87	98

5-23 Descriptive Model (Performance and Potential Index) MED & CEECs

There are two indicators for ranking countries with respect to FDI which are:
1) A "performance index" which relates the share of the FDI flows to a country to its share in the world GDP. An index above (below) one indicates that the couuntry attract more (less) FDI as a percentage of its economic dimension

2) A "potential index", which is calculated as simple average of 12 structural variables which corresponds to the main FDI determinants identified by theoretical and empirical models (market size, degree of openness, infrastructures, technologies, qualified labour force at low cost, natural resources endowment, regulatory framework, business climate and country risk which influence the degree of confidence of investors).

Evolution of Performance EuroMed



5-24 -Evolution of Performance Results:

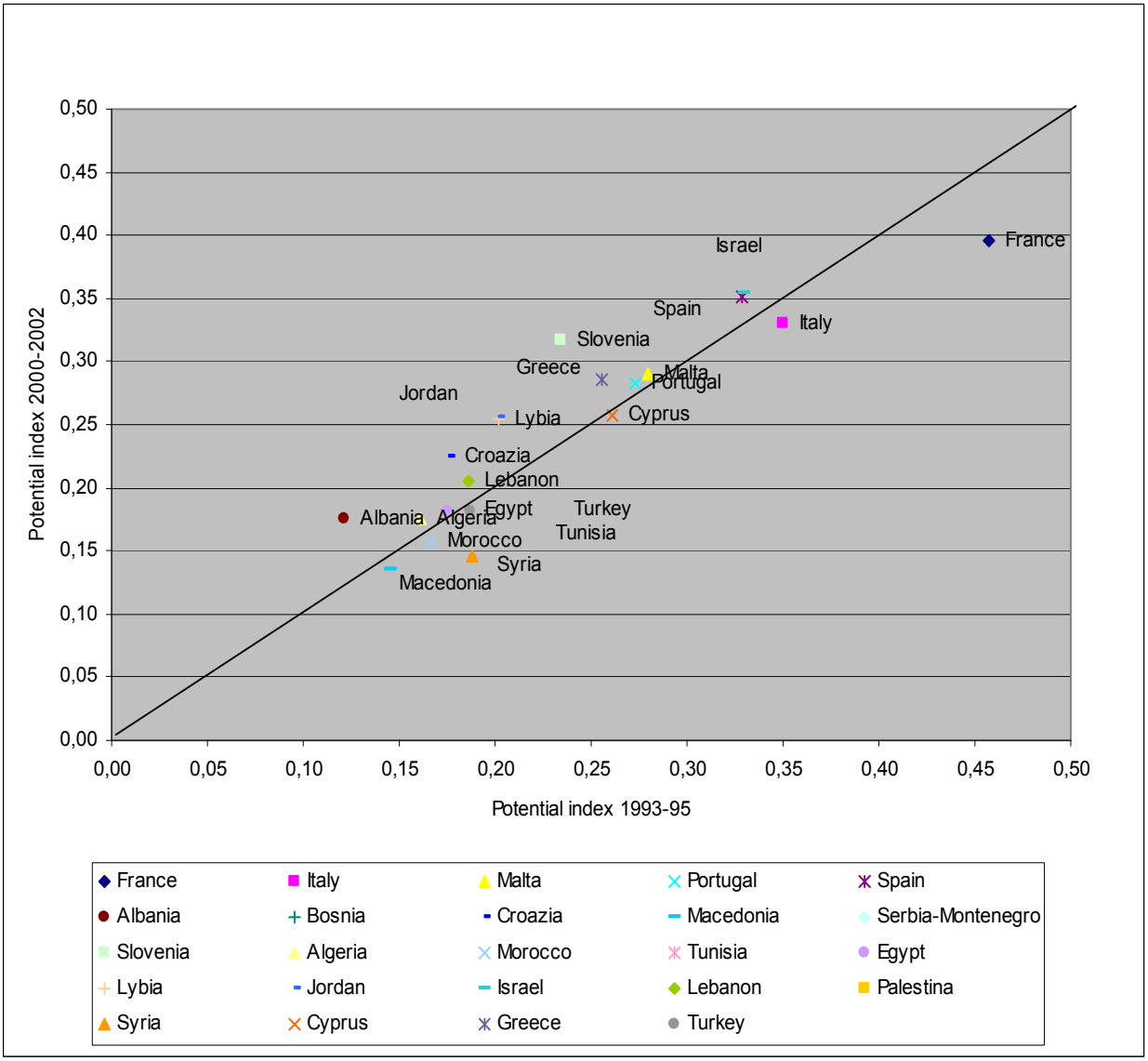
Only in few MED changes occurred over the last decade through economic reforms and the adoption of more friendly policy towards investors have translated into significant improvement, this is suggested by the evolution of the performance index over the period 1993-95 and 2000-2002.
Jordan, Algeria & Lebanon have realised an important increase in the index of development of FDI, But Tunisia, Egypt, Morocco, Syria, Turkey show a negative evolution.

5-25 - Performance of MED & CEECs in 2004: ranking over 140 countries

- MED lag behind at the international level: Libya is at the bottom of the list (116), followed by Turkey (111), Egypt (108), Algeria (95), Lebanon (90), Israel (83). Better Tunisia (67), Morocco (65), Jordan (48) and Syria (39).

- CEECs position is far better for most countries: Bulgaria 12, Estonia 16, Slovak R. 25, Czech R. 28, Croatia 33, Romania 35, Poland and Albania 42, Hungary 46, Latvia 47, Lithuania 59, Slovenia 60, Macedonia 72.

Evolution of Potential


0,50
0,45
0,40
0,35
0,30
0,25
0,20
0,15
0,10
0,05
0,00
Potential index 2000-2002
0,00
0,05
0,10
0,15
0,20
0,25
0,30
0,35
0,40
0,45
0,50
Potential index 1993-95
France
Israel
Spain
Italy
Slovenia
Greece
Malta
Portugal
Jordan
Lybia
Cyprus
Croazia
Lebanon
Albania
Algeria
Egypt
Turkey
Tunisia
Morocco
Syria
Macedonia
France
Italy
Malta
Portugal
Spain
Albania
Bosnia
Croazia
Macedonia
Serbia-Montenegro
Slovenia
Algeria
Morocco
Tunisia
Egypt
Lybia
Jordan
Israel
Lebanon
Palestina
Syria
Cyprus
Greece
Turkey

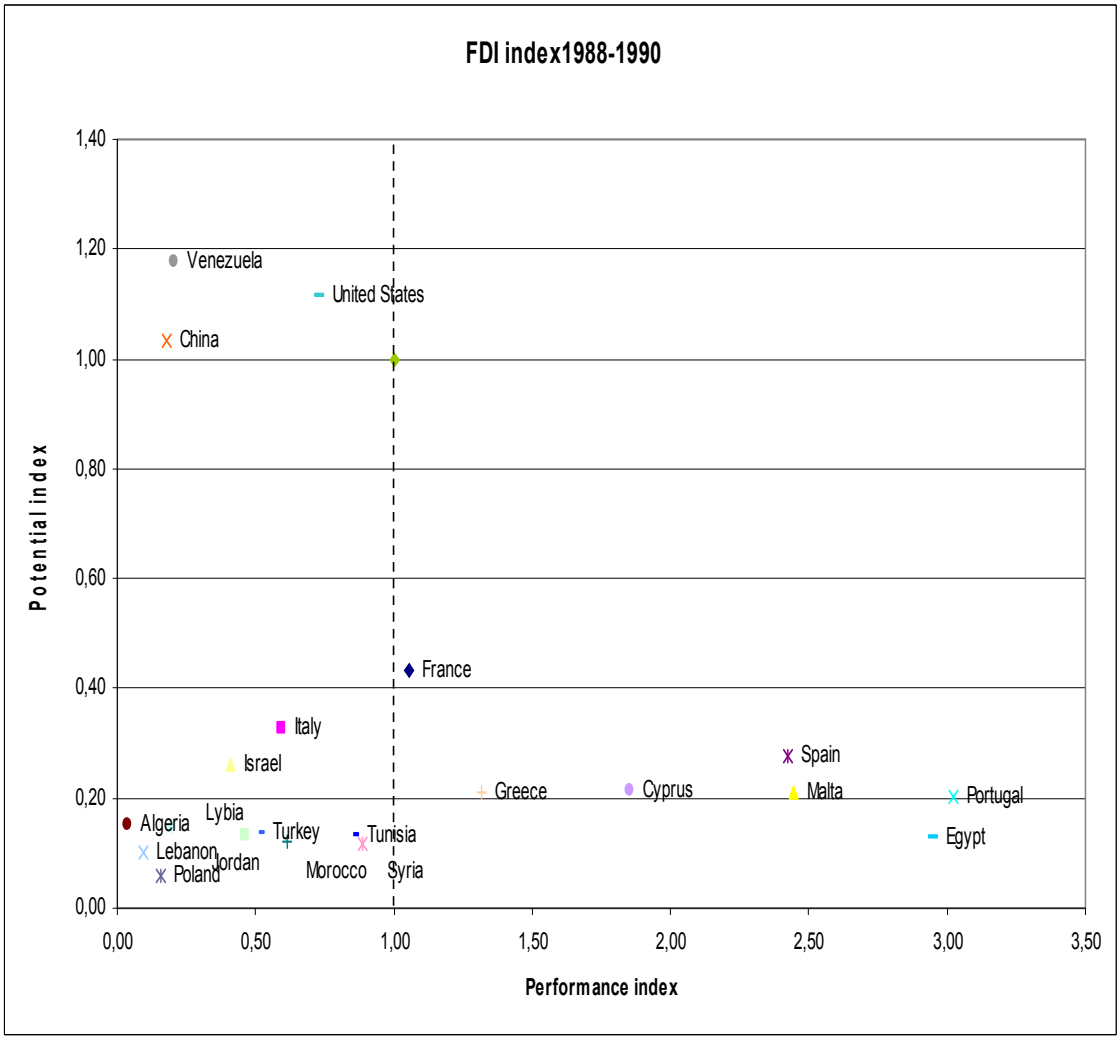
5-26 -Evolution of Potential Results:

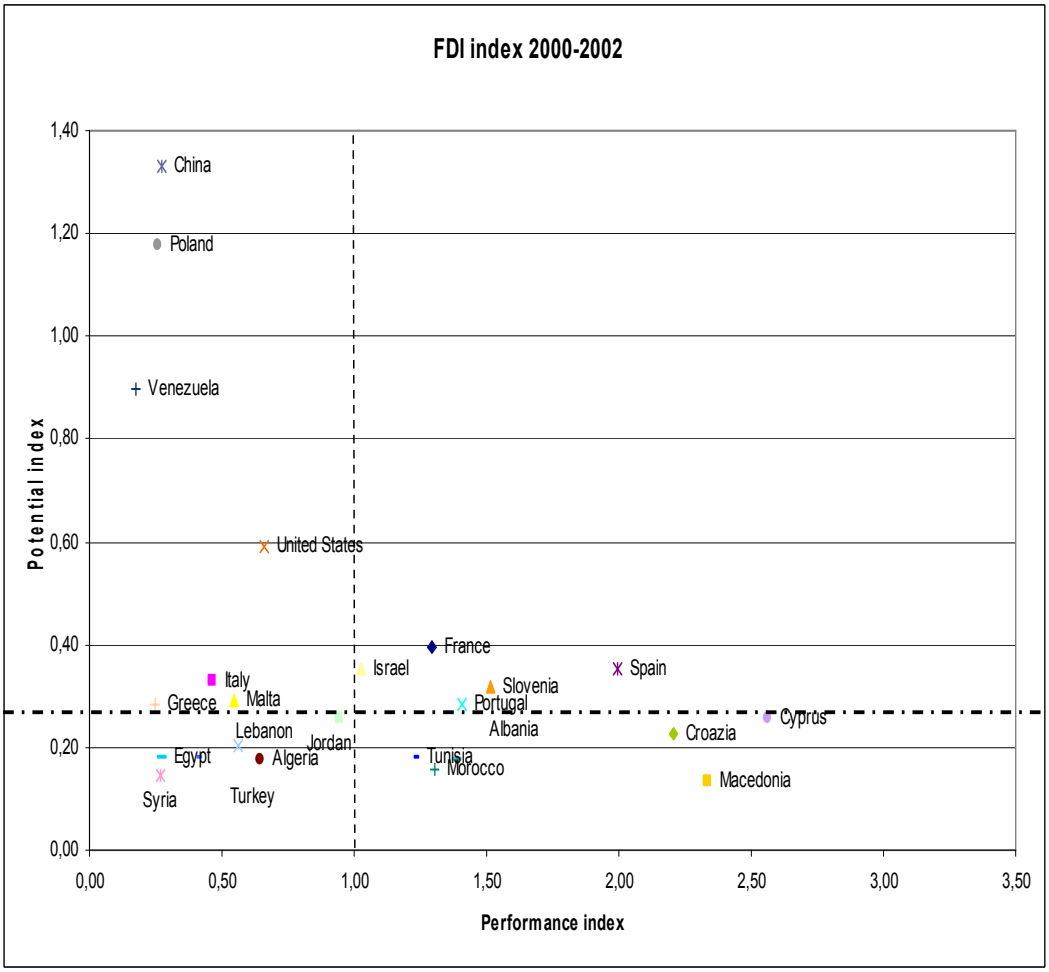
Most of the countries with upsetting FDI performance (Turkey, Tunisia, Morocco, Egypt, Syria) have had a negative or static dynamic also as far as the potential index is concerned and only Israel shows a big increase in potential from 0, 20 to almost 0, 40

UNCTAD ranking of countries according to the inward FDI potential index in 2003: USA (1), China (12), Slovenia (28), while Egypt 75 Morocco 87, Syria 95, and the MED (excluding Israel) are all from 60 downward.

5- 27 -Performance and Potential Countries Classify for FDI

1) MED with high performance combined with high potential (frontrunners): only Israel, close to Spain, France, Slovenia, Portugal and Cyprus.
2) MED with high performance but low potential (countries "above their potential"): Morocco, Tunisia, close to Albania, Croatia, and Macedonia.
3) MED with worrying position both as performance and as potential ("underperformers"), above all Egypt, Turkey, Syria, but also Jordan, Algeria, Lebanon.





5- 28 - The Gravity Model

The model is estimated with panel data techniques based on assembled data on bilateral FDI flows of fourteen European countries (EU15 excluding Belgium) and two non EU countries (USA and Japan), For each of these countries, we search for determinants of bilateral FDI flows into a large sample of developed and developing partners (74 partners), using many relevant explanatory variables (a broad version of the gravity model) for the years 1994-2004.

The empirical analysis proceeds in three steps. First we look for the determinants for outflows of FDI from the source countries analyzed, estimating the model with both fixed and random effects (Analysis of determinants).

Then, we proceed to the second step: we use these estimates to perform out-of-sample forecasts for FDI flows to both the CEECs and to the Southern Mediterranean countries, subsequently comparing these estimated flows with those that would be expected based on the empirical benchmark model described above (simulation analysis).

We would expect that actual capital flows to MED were below the expected flows because of the stock adjustment process that has to take place, although, the current situation might correspond to a sort of equilibrium taking into account the distortions to which the economic agents are submitted to in this area. For CEECs, the stock adjustment might have already taken place. Hence, actual and expected flows should not be strongly misaligned.

The perspective of adhesion of CEECs offered investors a guarantee that there will be no backtracking in the process of regulatory and institutional reforms in those countries. Conversely, in MED industries that faced difficulties (mostly public ones), have been privatised and restructured under the impulse and with the help of Europe, but the process did not take place at a sufficient scale.

Unlike MED, Eastern European countries moved towards a deeper integration not limited to a few tariff evolutions and were progressively adapting their legal framework and their practices to international standards. The current situation corresponds undoubtedly to a justified equilibrium taking into account these distortions.

5-29 - Theoretical explanations

There are also 'horizontal' FDI: similar types of production activities, owned by MNCs, taking place in different countries. This phenomenon is better clarified if multinational activity is not driven by factor endowments differences, but rather by the trade-off between proximity and concentration (Brainard 1993; Markusen and Venables, 1995).

The proximity advantage stems from 'firm-level' economies of scale, whereby R&D activity (or any other type of 'knowledge capital') is transferable to affiliates and allows MNCs to be closer to the foreign market.

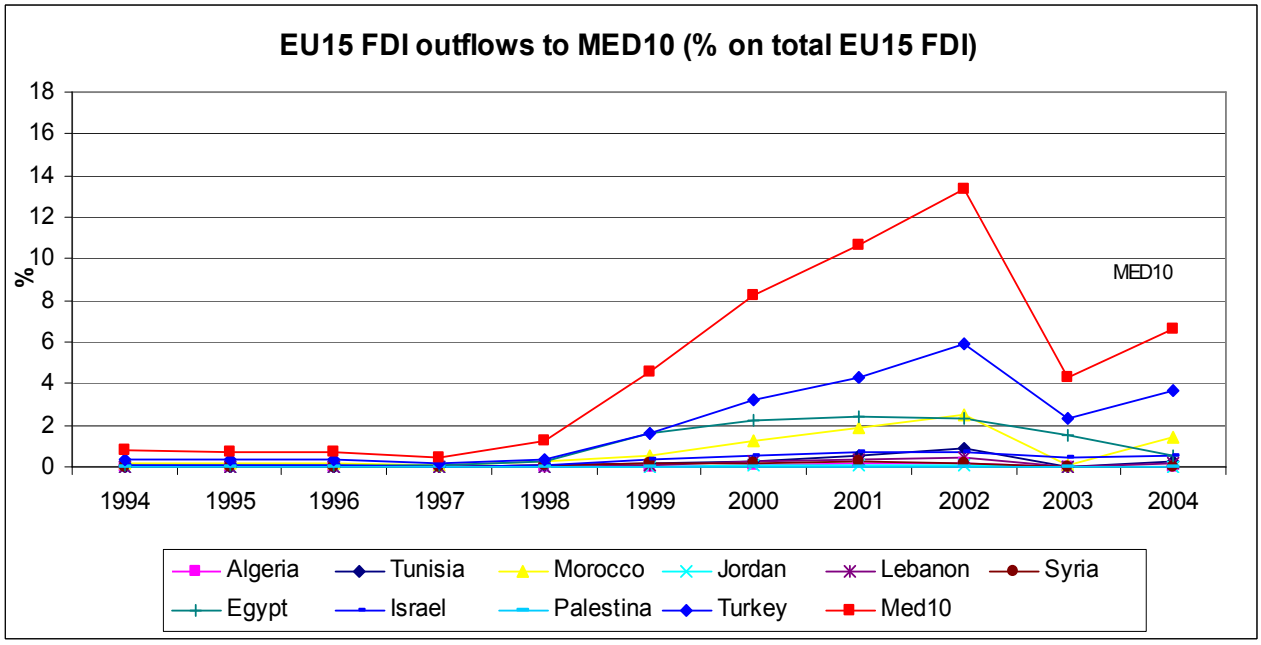
The concentration advantage derives from traditional 'plant-level' economies of scale, which make it more profitable to concentrate production in one location and then export. Whenever the former outweigh the latter, foreign investment will take place, and this will be more likely the higher are intangible assets relative to fixed costs of opening up an affiliate and the higher are transport costs, which are assumed to be positive and an increasing function of geographical distance in this model.

5- 30 - Is There a Diversion of FDI from MED to CEECs?

- A worrying stylised fact: Southern Mediterranean countries receive little FDI from most other regions in the world.
- FDI flows into some of them have tended to grow slowly over the 90s and to decline after 2000, while they have been booming in Central and Eastern Europe (CEECs).
- But a slow trend of growth up to 1997, an upsurge between 1997 and 1999 and a good performance up to 2002: overall from 5 to 15 billions $ and from less than 1% to almost 14% of total EU FDI; However, from 2002 to 2004 a strong decline has eroded previous results: a fall from almost 14 to 4 per cent, corresponding to a decrease of more than 10 billions USD (from 15 to 5 billions $).

5- 31 - EU investments in MED.

EU is the main provider of FDI to the South Mediterranean.
In 2004 the EU provided on average more than 70% of the FDI to MED10.
The European presence is not equally distributed in all the MED but for some countries it is really striking: Turkey received more than 75%, Morocco 73% (more than 95% in 2001), Tunisia 65%. And According to the MIPO database from ANIMA, 59% of the investment projects are coming from European investors, essentially France, Spain, the United Kingdom, and Germany.



5 – 32 - Simulation analysis

Use these estimates to perform forecasts for FDI flows to both the single CEECs and Southern Mediterranean countries, subsequently comparing these estimated flows to actual flows.
For CEECs, the stock adjustment might have already taken place. Hence, actual and expected flows should not be strongly misaligned. On the contrary, we would expect that actual capital flows to MED are much below the expected flows because the stock adjustment process still has to take place.
However, the current situation although not corresponding to an optimum allocation of resources, might also correspond to an equilibrium taking into account the distortions of various types that economic agents are submitted to in MED (actual flows not below expected).

5- 33 - Is there Diversion of FDI from MED to CEECs?

By using the gravity model to assess whether changes in FDI flows to CEECs which are economically integrating appear to be associated with negative changes in FDI flows to MED.

The methodological approach is based upon that of Sapir (1997) who sought to identify whether a "domino effect" had characterised the impact of European integration upon bilateral trade flows. We experiment by including interaction of regional dummies with dummy variables for particular sub-periods: 1994-1998 (transition period), 1998-2004 (pre-accession period) and for years, checking how regional dummies change.

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5- 24 Gravity model

When we get to the empirical analysis, to compare 'attractiveness' across countries and explain the geographic distribution of FDI we need a model that can pick up all these common determinants; To synthesise the two approaches discussed above, i.e. Helpman and Krugman's treatment of vertical FDI and Brainard's of horizontal one.

The model includes the following main variables:

A measure of the 'economic space' between the two countries, given by the sum of the two GDPs and by the two country's populations to catch the 'market-seeking' aspect of FDI

The relative factor endowments, an index of countries' similarity in size measured by their relative GDP; additional variables, such as distance, a common language, a common border, or preferential trade agreements, that may reduce the costs (transaction and transportation costs) of locating abroad and which can be introduced via dummy variables.

This type of gravity model approach has also applied to studies of FDI as a means of picking up the common determinants of FDI flows across countries (Eaton and Tamura, 1996; Brenton and Di Mauro, 1999), Alessandrini and Ferragina.

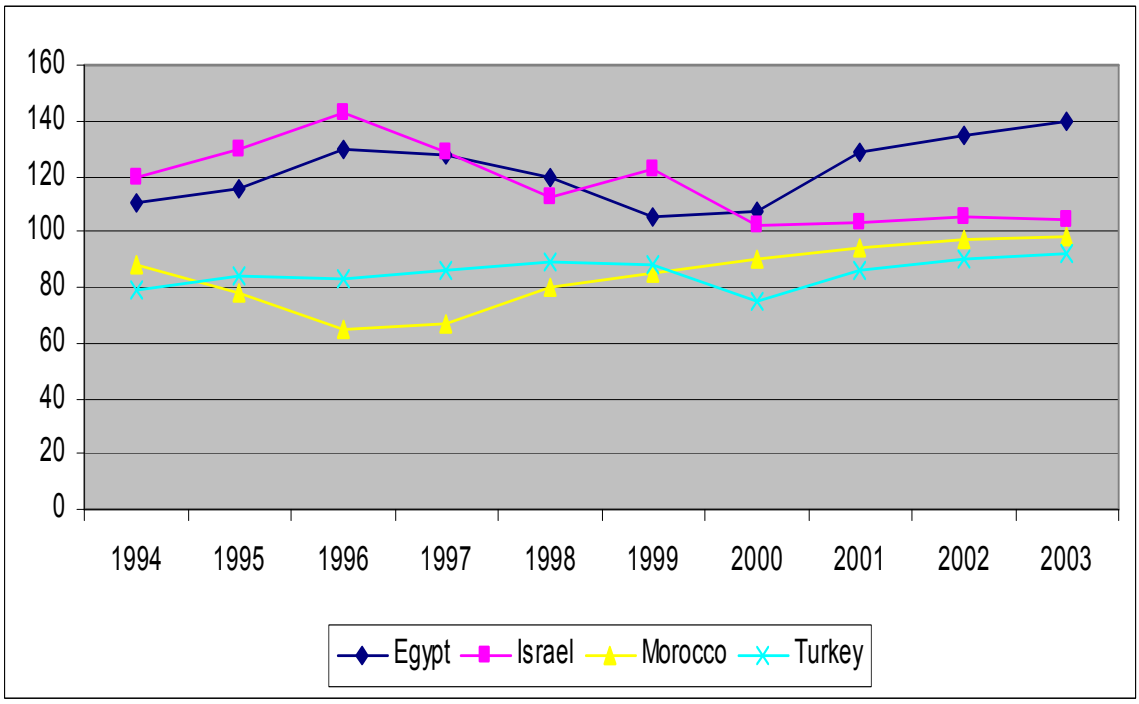
5-25 Enlarged gravity model

We apply this type of model but we propose a "broad" version:

factors traditionally considered in gravity models such as proximity and market size should make countries attractive locations for FDI and should play a decisive role, but moving from the consideration that the success of FDI attractiveness of CEECs was mainly due to the prospects of EU membership and to the fact that most CEECs have succeeded in attaining both institutional and political stability; we attempt to explain FDI shortfalls of MED with a gravity model enlarged to include policy and institutional factors

5- 26 Simulation Analysis:

- The simulation concerns the expected or "normal" FDI flows to each single MED and CEECs (that would be expected based on the empirical benchmark model described above) compared with actual FDI flows.
- Our expectation would be that, if the adjustment process was quite fast (slow) FDI flows are above (below) the average level of flows expected to countries with comparable attributes.
- For MED we would expect not to observe a strong catching-up effect in the past years in spite of the fact that these economies are underdeveloped as compared to average industrialised countries and in need to adjust and to catch up



Italy FDI flows to MED: simulated in % of actual

5 – 27 Gravity model Specification

In (Bilat FDIijt) = Traditional gravity: β0 + β1 ln SUMGDPijt + β2 ln POPit + β3 ln POPjt +β4 lnDiffGDPPCijt +β5 ln Distij + β6ln Areasij + β7 LLij+ β8 Borderij + β9 Langij + β10 Colonialij + policy and instit. + β 11 Regionalijt + β12 ln (IMP/GDP)jt + β 13 ln (M2/GDP)jt + β 14 ERVijt + β 15 CUijt + β16 Govijt + β17 FTAijt +β18 Humcapjt +β19 Current + β20 Capital + regional and time dummies + β21 EUij + β22 MED+ β23 CEECs + β24 YEAR Dummies

Where i and *j* denotes donor and host country respectively, *t* denotes time
FDIij is the value of the FDI flow from country *i* (home country) to country *j* (host country) and the variables are defined as follows:

SUMGDPijt	is the sum of nominal value of the gross domestic product in i and j
POPi & POPj	is the population of i and j
DiffGDPPCijt	is the absolute difference in per capital income between i and j (a proxy for relative factor endowment)
Distij	is the Great Circle Distance between i and j in miles
Areas	is the sum of the areas of i and j in square kilometres (hence a proxy for distance within the country to the border)
LLij	is a dummy variable, which is 0 if no countries are landlocked, 1 if one partner is landlocked
Borderij	is a binary variable, which is 1 if i and j share a border and 0 otherwise
Langij	is a binary variable, which is 1 if i and j share an official language and 0 otherwise
Colonialij	is a binary variable, which is 1 if i colonized j
Regionalijt	is a binary variable, which is 1 if i and j belong to a Regional Trading Agreement in year t
IMP/GDPj	a proxy for the openness of a country to foreign trade
ERVijt	is the volatility of the bilateral nominal exchange rate between i and j in period t
CUijt	is a binary variable, which is 1 if i and j use the same currency at time t
Govjt	is the sum of six governance indices of j at t
FTA	is a dummy variable defined as 1 if only one of the countries is in a regional trading agreement (and 0 otherwise) proxy measure of trade diversion
Current &Capital	is a variable coded 1 if host country has current and capital account restrictions respectively
MED	is a dummy variable which is 1 when host countries are MED10 countries. (Libya, Turkey, Egypt, Algeria, Lebanon, Israel, Tunisia Morocco, Jordan, Syria)
CEEC	is a dummy variable for belonging to CEEC.(Bulgaria , Estonia , Slovak R. , Czech R. , Croatia , Romania , Poland, Albania , Hungary , Latvia , Lithuania , Slovenia , Macedonia
EU	is a dummy variable for EU membership of i
M2	notes and coins in circulation plus non-interest-bearing bank deposits plus building society deposits plus National Savings accounts

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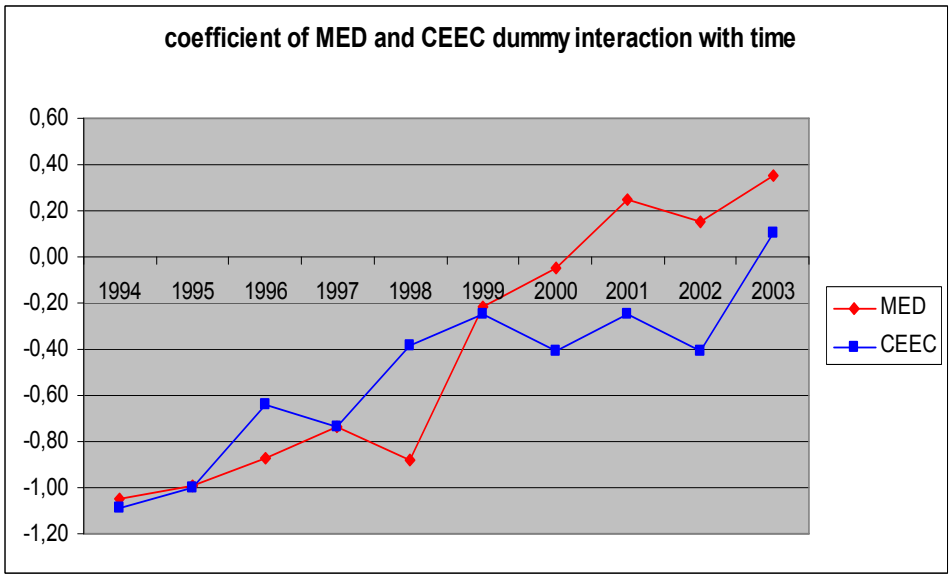
Simulation analysis

Use these estimates to perform forecasts for FDI flows to both the single CEECs and Southern Mediterranean countries, subsequently comparing these estimated flows to actual flows.
For CEECs, the stock adjustment might have already taken place. Hence, actual and expected flows should not be strongly misaligned.
On the contrary, we would expect that actual capital flows to MED are much below the expected flows because the stock adjustment process still has to take place.
However, the current situation although not corresponding to an optimum allocation of resources

5 – 28 Empirical results

Here we present the results of the regression analysis of bilateral FDI flows by major investing countries over 1994-2004; the gravity model introduced is used to define a "normal pattern" of bilateral FDI flows; Dummy variables are included for three groups of countries EU, CEECs, MED10 to get a very preliminary test for a possible divergence from this pattern: If the corresponding coefficients are significant and negative➔ we interpret this as evidence that the group has received less FDI than other countries after controlling for all the other factors; therefore, the group concerned can expect to benefit from further large FDI inflows as foreign investors adjust their stocks to the new opportunities created by economic transformation and If the dummies are not significant, the future growth of the FDI flows can be expected to be in line with changes in the determinants of FDI.

increasing CEEC integration over the 1990s, culminating into the accession for most of them, had any noticeable negative impact upon FDI flows from EU countries going to the MED10; We experiment by including the interaction of regional dummies with time dummies for particular sub-periods: 1994-1998 (transition period), 1998-2004 (pre-accession period) and for years.



5- 29 RESULTS: Diversion of FDI from MED to CEECs?

- The MED countries in the 1994-1998 were receiving substantially less FDI than could be expected on the basis of their incomes and proximity to the EU and to other variables; however, the magnitude of this 'under potential' weakened in the late 1990s and in the first half of the 2000s which may suggest that the enlargement process did not adversely affected the magnitude of inward FDI from EU countries.
- Hence, our, albeit limited, analysis finds no evidence to suggest that the intensification of FDI in CEECs, following integration with the EU, has had a discernible dampening effect on FDI flows going to MED.

5- 30 Eenlarged gravity:

As expected Border, Language, Regional agreement all have positive and significant effects on FDI levels, CU (Currency Union) is significant and positive.

FTA (free trade agreement) not significant effect, indicating that for the full sample there has been no discernible trade diversion effect of FTAs, Colonial links not significant too.

The import on GDP coefficient is also not significant.

Volatility of exchange rate is positive and significant: FDI more stable and less risky than portfolio and trade activities?

Governance is highly significant with positive sign (very robust variable).

Current and capital account restrictions are both negative and highly significant.

5 – 31 Simulation results by country & by years

-The calculations for these four MED indicate that most of them attracted almost 100% of the total expected FDI inflows; -A downward shift in inflows for Israel with slight increases for Egypt and Morocco, Turkey; -Interaction of regional dummies with time dummies: how they have been changing over two periods (1994-1998, 1999-2004)? And year by year

-Negative and significant dummy for CEECs both in 1994-1998 and in 1999-2004 (most years show a negative and significant dummy).

-For MED negative and significant for the first period but not significant and positive in the second period (in each year from 1999 to 2004).

5 – 32 Conclusions from Gravity Model.

The current situation of FDI in MED although does not correspond to an optimum allocation of resources corresponds to an equilibrium taking into account the distortions that economic agents are submitted to; Rejection of the hypothesis of FDI diversion away from the MED.

FDI in these countries have come down because the instability in institutional and policy. It is from the issue of the FDIs that one can best perceive the necessity to modify the business environment and the behaviour of the enterprises but also the role of anchorage which EU can play.

During the same period, Eastern Europe offered promising long term perspectives on this ground enhanced by the perspective of adhesion which also offered investors a guarantee of regulatory and institutional reforms

Industries that faced difficulties (most of the time public ones), have been privatised and restructured under the impulse and with the help of Europe, a process that did not take place at a sufficient scale in the MED

-As a result CEECs moved towards a deeper integration not limited to a few tariff evolutions and are progressively adapting their legal framework and their practices to international standards

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Chapter six: The emprical Model, an approach to valuate FDI Inflow & Outflow Performance:

6. 1 - Statistic and econometric explanation

We use the Cluster Analysis, and dissimilarity matrix technique, with "DIANA" function to make the cluster analysis with S- PLUS software.

Cluster Analysis is the searching for groups (cluster) in the data, in such way that objects belonging to the same cluster resemble each other, whereas objects in diffirent clusters are dissimilar.

By using Hirerachical algorithms category which is a describes a method yielding an entire hierarchy of clusterings for the given data set. Agglomerative methods start with the situation where each object in the data set forms its own little cluster, and then successively merges clusters until only one large cluster remains which is the whole data set.The functions agens, MCLUST and HCLUST use agglomerative methods.
Divisive methods start by considering the whole data set as one cluster, and then splits up clusters until each object is separate. And algorithms of this type are used in the functions DIANA and MONA.

Dissimilarity Matrix 2 * 2 where d(i , j) = d(j, i) measure the "difference" or Diddimilarity between the objects I and J. this kind of data occurs frequently in the social sciences and in marketing.
Although we refer to the object produced by daisy or d i s t as a dissimilarity matrix, it is actually a vector representing the belowdiagonal elements of such a matrix, with additional attributes giving information such as the number of observations.
Dissimilarities The dissimilarity between two objects measures how different they are. Sometimes we can use an actual metric (distance function) between objects, but a dissimilarity function is not necessarily a metric. Often only the following three axioms of a metric are satisfied:

1. d(i, i) = 0
2. d(i, j) >_ 0
3. d(i, j) = d(j, i)

How we compute the dissimilarity between two objects depends on the type of the original variables. by default, numeric columns are treated as interval-scaled variables, factors are treated as nominal variables, and ordered factors are treated as ordinal variables. The type argument to daisy may be used to specify that a column should be treated in a manner other than the default.

6.2 Interval-scaled variables

Interval-scaled variables are continuous measurements on a (roughly) linear scale. Typical examples are temperature, height, weight, and energy.
If all variables are interval-scaled, we can use an actual metric such as:

$$d(i, j) = \text{Square} \sum_{f=1}^{p} (xif - xif)|\, 2 \qquad \text{(Euclidean distance)}$$

or

$$p$$

$$d(i, j) = \text{Square} \sum_{f=1} |xif - xif| \qquad \text{(Manhattan distance)}$$

There are different ways to compute dissimilarities for ratio-scaled variables:
1. Simply as interval-scaled variables, though this is not recommended as it can distort the measurement scale.
2. As continuous ordinal data.
3. By first transforming the data, perhaps by taking logarithms, and then treating the results as interval-scaled variables.
4. Discrete ordinal variables
A discrete ordinal variable has M possible values (scores) which are ordered. The dissimilarities are computed in the same way as for continuous ordinal variables.
5. Nominal variables
Nominal variables have M possible values, which are not ordered. The dissimilarity between objects i and j is usually defined as:

$$d(i, j) = \frac{\text{\# variables taking different values for i and j}}{\text{total number of variables}}$$

This is called the simple matching coefficient

6.3 Graphical Display: The hierarchy obtained from di ana can again be graphically displayed either as a clustering tree or as a banner. Note that the divisive coefficient (D C) defined above can also be defined as the average width (or the percentage filled) of the banner plot.

6.4 How we build our Model:

After having a good understood to the subject International Trade, and the internationalization importance and the history of the company. And learn much more about the FDI and FDI Management, looking into different resources to learn more and reading a lot of papers, whether during the several congresses which I followed, whether during my research following my teachers and tutor about this subject.

Then after studying the subject, and going to the next step with more important instrument to create the empirical model about the subject, and found the more useful models about the subject, and create a new one, following the modern instrument for this kind of research; and going to the dataset available and we can trust on, and how we select the best variables? And if the model can help us to understand the FDI performance and trend? What kind of information can give us? And how we can read the results from both the economic and the empirical points of view? Whether for the singular European country performance, whether for the group countries performance, by making the cluster countries.
And look how the same variables make a different effect on EU 27, here we can make to many cluster analysis from each variable point of view, FDI Inflow, GDP per capita, Export, Import ….

Finally to put all these results to help the small and medium Italian companies when they need to grow in a new market, following the internationalization and its steps.

6. 5 – The Beginning of the Model research

The question is: what are the variables which have more influence on the FDI Inflow and Outflow?

- So we have a two approaches one for the FDI Inflow and other for the FDI Outflow.

The function *FDI* inflow = ⌠ (Import+ Export + GDP per capita + six governance indicators + area + population or GDP per capita + education level + technological level.

The function of FDI Outflow is:
FDI outflow = ⌠same variables but without the Import.

6. 6 - The effect of the Variables

- an example put the variable Export with the FDI inflow model, can give us an important result and help to know rapidly when can make a new investments, because when the export size is high in a country, that mean if the company make its investment in this country which has a high export (textile in Tunisia) as signal to Italian investors to make their investments in textile sector.

- Also is more significant use the variable GDP per capita to know how much the market is rich, but the variable population is a factor to a large market.

- Also take the variable country education level is measure to know if it is important the relation between FDI inflow and education level, and if it is relevant or not? For this indicator I select the number of university enrolment ratio from each 100 habitant.

- For the variable Area I found that it was used in some papers about some industries which are interested in the chemical and military industry ,whether for the high quiet and the security of people, whether for to the severe environment conditions, and in both they need a huge space.

- The Import variable is an indicator to the investors to go to this country which has e high import level, and make the investment in this sector (e.g. the textile sector in Syria needs to import a high quantity of row material necessary for some steps of chemical transformation, and that gives an incentive to a lot to of new private and government investors in this sector.

- Also I select the variable country technological level, to know if it is relevant the degree between FDI Inflow and the country technological level or not?

Also the six governance indicator is an number between -2.5 , + 2.5 as sum of six numbers which are : (Voice of accountability, Political stability, Government effectiveness, Regulatory quality, Rule of law, control of corruption) calculated by International Country Risk Guide..

- After the examination to the matrix of correlation between the variables which was used in the empirical model

6. 7 - The model explain

Here we separate EU 27 to EU 15 and EU 12 + China + India:

EU 15	Austria. Belgium. Belgium –Luxembourg. Denmark. Finland. France. Germany. Greece. Ireland. Italy. Holland. Portugal. Spain. Sweden. U.K
EU 12	Cyprus. Czech-Republic.. Estonia. Hungary. Latvia. Lithuania .Malta. Poland. Slovakia. Slovenia. Bulgaria. Romania

The model is estimated with panel data techniques based on assembled data on FDI Inflow and Outflow of European countries (EU25, EU12 + china + India.

The empirical analysis could proceeds in several steps. First we look for the determinants of FDI Inflow (analysis of determinants).

Then, we proceed to the second step: we use these estimates to analysis the FDI Inflow performance in each single country in EU 27. Also compare with India and China as two countries which receive a high world FDI.

And going to make a cluster analysis between EU 27, + India and China, whether the same effect of the variables on the country FDI Inflow, whether of more specific analysis about the effect of each single variable on the EU 27 + China, India.

6. 8 - The Empirical Model Target

It is an approach to know the FDI country effect and Look at variables which have more influence on the FDI; started with EU 27 compared with India & China., and to know how is the FDI performance in the 12 new entries Europe, to make finally cluster analysisto our countries from several FDI points of view: FDI Otflow, FDI Inflow, Impot, export, GDP per capita, Population; and the results of this kind of analysis help the companies which look for new market.

- Then to make a counties cluster analysis by all variables from the FDI Outflow and FDI Inflow point of view.
- Also to make a cluster analysis to each singlevariable.

6. 9 - The Period & variables used

Period: 1980 – 2004 to all the FDI inflow & Outflow variables.
So for the Model I used these variables, which I explain why I used them, whether for the Inflow Model, whether for the Outflow Model.

The question is: what are the variables which by them we can know the FDI Inflow function and performance? To creat an approach to valuate the FDI Inflow & outflow trend.

THE VARIABLE	*To measure*	*Resources*
Export size	FDI potential & industrial level	UNICTAD
Import size	FDI potential	UNICTAD
FDI Outflow	FDI power & country trade policy	UNICTAD
FDI Inflow	FDI Incentives	UNICTAD
GDP per capita	Rich market	UNICTAD
Population	Huge market	UNICTAD
Direct Investment abroad	FDI Market share	UNICTAD
Education level (University enrolment ratio)	The relation between FDI and Education level!	UNICTAD
Technological level: - Main telephone lines per 100 in habitants. Tech1 - Mobile phone subscribers per 100 in habitants. Tech 2 - Television sets per 1000 inhabitants. Tech 3 - Internet user for 1000 in habitants. Tech 4 - Personal computers per 1000 inhabitants. Tech 5	The relation between FDI and Technological level!	UNICTAD
Six governance indicators are: Voice of accountability Political stability Government effectiveness Regulatory quality, Rule of law, control of corruption	Country attractiveness	UNICTAD Kaufamn, Kray and Zoido-Lobat IMF Country Risk

6. 10 - The Two FDI Performance approaches:

6 – 10 - 1 - The FDI Inflow Empirical Model

Log (FDI Inflow) = Log Exp + log Imp +Log GDP per capita + Log Population + log D.I.A

6.10. 1. 1 - The kind of results from the model :

From this first model we obtain two kind of results :
The first is we can notice the vriables performance on each single European country, also India and china.

The second to make a Cluster analysis to all the EU groups, India and China, to be able to make similsrs FDI Inflow Performance groups.

6- 10. 1. 2 - the first Empirical Results

: EU 27 + CHINA + INDIA

AUSTRIA

	Value	Std. Error	t value	Pr(>|t|)
(Intercept)	-30.9277	30.6422	-1.0093	0.3278
log(EXPORT)	2.8644	2.6044	1.0998	0.2877
log(IMPORT)	-2.8135	3.6367	-0.7737	0.4504
log(GDP. Capita)	-4.7538	5.6797	-0.8370	0.4149
log(Dir.Inv.Ab.)	0.8405	0.1855	4.5298	0.0003
log(population)	47.9159	20.8292	2.3004	0.0352

Multiple R-Squared: 0.9154

BELGIUM

Coefficients:

	Value	std. Error	t value	Pr (>|t|)
(Intercept)	1399.5050	654.7540	2.1375	0.0764
Log (EXPORT)	-4.0026	4.2312	-0.9460	0.3807
Log (IMPORT)	6.9670	4.7195	1.4762	0.1903
Log (GDP. Capita)	-27.7546	16.6390	-1.6680	0.1464
Log (Dir.Inv.Ab.)	0.0743	0.3324	0.2235	0.8306
Log (population)	-517.1071	241.5624	-2.1407	0.0761

Multiple R-Squared: 0.7305

BULGARIA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	139.7654	37.4016	3.7369	0.0202
Log (EXPORT)	-0.9034	0.6052	-1.4928	0.2098
Log (IMPORT)	2.9813	1.3572	2.1967	0.0930
Log (GDP. Capita)	-7.8161	2.9008	-2.6945	0.0544
Log (Dir.Inv.Ab.)	-0.0167	0.0681	-0.2447	0.8187
Log (population)	-53.2621	9.9038	-5.3780	0.0058

Multiple R-Squared: 0.9692

CYPRUS

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	82.8708	59.2720	1.3981	0.1956
Log (EXPORT)	0.5354	0.3262	1.6412	0.1352
Log (IMPORT)	-0.7545	2.2829	-0.3305	0.7486
Log (GDP. Capita)	0.8432	2.8827	0.2925	0.7765
Log (Dir.Inv.Ab.)	-7.3169	6.4411	-1.1360	0.2853
Log (population)	46.2345	14.4800	3.1930	0.0110

Multiple R-Squared: 0.9352

CZECH. REPUBLIC

Coefficients

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	1399.5050	654.7540	2.1375	0.0764
Log (EXPORT)	-4.0026	4.2312	-0.9460	0.3807
Log (IMPORT)	6.9670	4.7195	1.4762	0.1903
Log (GDP. Capita)	-27.7546	16.6390	-1.6680	0.1464
Log (Dir.Inv.Ab.)	0.0743	0.3324	0.2235	0.8306
Log (population)	-517.1071	241.5624	-2.1407	0.0761

Multiple R-Squared: 0.7305

DENEMARK

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-30.9277	30.6422	-1.0093	0.3278
Log (EXPORT)	2.8644	2.6044	1.0998	0.2877
Log (IMPORT)	-2.8135	3.6367	-0.7737	0.4504
Log (GDP. Capita)	-4.7538	5.6797	-0.8370	0.4149
Log (Dir.Inv.Ab.)	0.8405	0.1855	4.5298	0.0003
Log (population)	47.9159	20.8292	2.3004	0.0352

Multiple R-Squared: 0.9154

ESTONIA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-49.4752	41.3422	-1.1967	0.2704
Log (EXPORT)	3.0446	3.3905	0.8980	0.3990
Log (IMPORT)	-1.0464	2.1507	-0.4865	0.6415
Log (GDP. Capita)	2.1490	1.8524	1.1601	0.2840
Log (Dir.Inv.Ab.)	-0.1169	0.1163	-1.0050	0.3484
Log (population)	25.8019	32.9544	0.7830	0.4593

Multiple R-Squared: 0.8591

FINLAND

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-66.0594	21.1478	-3.1237	0.0062
Log (EXPORT)	1.4673	1.9537	0.7511	0.4629
Log (IMPORT)	-1.0074	1.6762	-0.6010	0.5557
Log (GDP. Capita)	4.8158	4.5051	1.0690	0.3000
Log (Dir.Inv.Ab.)	0.4076	0.1087	3.7487	0.0016
Log (population)	7.9003	25.2554	0.3128	0.7582

Multiple R-Squared: 0.9524

France

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	2.6765	19.1330	0.1399	0.8902
Log (EXPORT)	4.4774	1.4835	3.0181	0.0071
Log (IMPORT)	-3.3999	1.4257	-2.3847	0.0277
Log (GDP. Capita)	8.4011	5.0501	1.6635	0.1126
Log (Dir.Inv.Ab.)	0.2617	0.1273	2.0554	0.0538
Log (population)	-24.3374	16.4427	-1.4801	0.1552

Multiple R-Squared: 0.9731

Germany

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-225.7170	328.6979	-0.6867	0.5179
Log (EXPORT)	-8.2052	11.9947	-0.6841	0.5195
Log (IMPORT)	12.1031	12.0696	1.0028	0.3547
Log (GDP. Capita)	22.5377	10.0926	2.2331	0.0670
Log (Dir.Inv.Ab.)	0.4532	0.4321	1.0489	0.3346
Log (population)	-16.1556	84.1140	-0.1921	0.8540

Multiple R-Squared: 0.8418

GREECE

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	20.4565	30.8905	0.6622	0.5203
Log (EXPORT)	-0.3448	0.8179	-0.4216	0.6808
Log (IMPORT)	0.9565	0.7045	1.3577	0.1995
Log (GDP. Capita)	-1.3221	2.8742	-0.4600	0.6538
Log (Dir.Inv.Ab.)	0.2531	0.1968	1.2859	0.2227
Log (population)	-6.2416	5.2065	-1.1988	0.2537

Multiple R-Squared: 0.8454

Hungary

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	772.9802	614.2322	1.2584	0.2550
Log (EXPORT)	3.3645	1.8960	1.7745	0.1263
Log (IMPORT)	-7.0365	3.0478	-2.3087	0.0604
Log (GDP. Capita)	-10.5546	13.6990	-0.7705	0.4703
Log (Dir.Inv.Ab.)	0.1843	0.0774	2.3797	0.0548
Log (population)	-264.7254	212.3121	-1.2469	0.2589

Multiple R-Squared: 0.5908

IRELAND

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-9.2881	23.8349	-0.3897	0.7058
Log (EXPORT)	2.5346	4.1455	0.6114	0.5560
Log (IMPORT)	-5.2012	4.3815	-1.1871	0.2656
Log (GDP. Capita)	12.5544	4.7976	2.6168	0.0280
Log (Dir.Inv.Ab.)	0.1262	0.3530	0.3574	0.7290
Log (population)	-47.1809	24.5953	-1.9183	0.0873

Multiple R-Squared: 0.9098

ITALY

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	361.7560	256.1969	1.4120	0.1814
Log (EXPORT)	0.7471	2.3446	0.3186	0.7551
Log (IMPORT)	0.0448	1.8834	0.0238	0.9814
Log (GDP. Capita)	8.0591	5.4352	1.4828	0.1620
Log (Dir.Inv.Ab.)	0.4424	0.3231	1.3689	0.1942
Log (population)	-111.1644	70.3532	-1.5801	0.1381

Multiple R-Squared: 0.7965

LATVIA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	2.7312	40.9434	0.0667	0.9490
Log (EXPORT)	-3.4653	2.9989	-1.1556	0.2918
Log (IMPORT)	4.5523	2.2018	2.0676	0.0842
Log (GDP. Capita)	-2.4034	1.7304	-1.3889	0.2142
Log (Dir.Inv.Ab.)	-0.1685	0.1759	-0.9579	0.3751
Log (population)	5.6386	21.4786	0.2625	0.8017

Multiple R-Squared: 0.8876

LITHUANIA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-438.9260	502.6277	-0.8733	0.4318
Log (EXPORT)	-5.3433	6.1108	-0.8744	0.4313
Log (IMPORT)	7.4639	7.2813	1.0251	0.3633
Log (GDP. Capita)	8.1410	11.7385	0.6935	0.5261
Log (Dir.Inv.Ab.)	-0.0092	0.2076	-0.0442	0.9669
Log (population)	265.8549	322.6287	0.8240	0.4562

Multiple R-Squared: 0.7217

NETHERLANDS

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-62.0847	15.9809	-3.8849	0.0011
Log (EXPORT)	-0.4302	2.7907	-0.1541	0.8792
Log (IMPORT)	1.7618	2.9489	0.5975	0.5576
Log (GDP. Capita)	15.6644	5.2916	2.9603	0.0084
Log (Dir.Inv.Ab.)	0.1966	0.3089	0.6365	0.5325
Log (population)	-40.4578	17.2034	-2.3517	0.0303

Multiple R-Squared: 0.953

POLAND

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-227.0962	29.5400	-7.6878	0.0000
Log (EXPORT)	-2.7581	1.3230	-2.0848	0.0516
Log (IMPORT)	6.0143	0.7475	8.0454	0.0000
Log (GDP. Capita)	-5.2487	2.6616	-1.9720	0.0642
Log (Dir.Inv.Ab.)	-0.2233	0.1470	-1.5192	0.1461
Log (population)	60.6771	9.5533	6.3514	0.0000

Multiple R-Squared: 0.9675

PORTUGAL

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-0.5619	17.4322	-0.0322	0.9746
Log (EXPORT)	0.5713	0.8731	0.6543	0.5208
Log (IMPORT)	-2.0968	1.2110	-1.7315	0.0996
Log (GDP. Capita)	11.6764	3.9787	2.9348	0.0085
Log (Dir.Inv.Ab.)	0.1266	0.0892	1.4185	0.1722
Log (population)	-31.2927	11.5485	-2.7097	0.0139

Multiple R-Squared: 0.8604

ROMANIA

Coefficients:

	Value	Std. Error	t value	Pr(>|t|)
(Intercept)	683.4163	1074.7453	0.6359	0.5451
Log (EXPORT)	4.9295	13.5384	0.3641	0.7265
Log (IMPORT)	1.3330	12.2941	0.1084	0.9167
Log (GDP. Capita)	-22.4077	19.6695	-1.1392	0.2921
Log (Dir.Inv.Ab.)	-1.7115	0.9939	-1.7220	0.1287
Log (population)	-194.7067	350.4578	-0.5556	0.5958

Multiple R-Squared: 0.8443

SLOVAKIA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	127.1750	333.5176	0.3813	0.7224
Log (EXPORT)	-3.0920	2.3303	-1.3269	0.2552
Log (IMPORT)	-1.7004	3.4194	-0.4973	0.6451
Log (GDP. Capita)	25.8056	17.0243	1.5158	0.2042
Log (Dir.Inv.Ab.)	-0.3599	0.1589	-2.2651	0.0862
Log (population)	-150.1807	257.8606	-0.5824	0.5915

Multiple R-Squared: 0.8618

SLOVENIA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-133.0221	105.5800	-1.2599	0.2481
Log (EXPORT)	6.3089	3.7360	1.6887	0.1351
Log (IMPORT)	-5.8929	3.6151	-1.6300	0.1471
Log (GDP. Capita)	0.7010	6.1334	0.1143	0.9122
Log (Dir.Inv.Ab.)	0.0567	0.2956	0.1918	0.8534
Log (population)	180.4717	192.1474	0.9392	0.3789

Multiple R-Squared: 0.6316

SPAIN

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-148.9117	21.2824	-6.9969	0.0000
Log (EXPORT)	-3.0240	0.4699	-6.4359	0.0000
Log (IMPORT)	2.3670	0.4251	5.5688	0.0000
Log (GDP. Capita)	3.1944	0.9047	3.5308	0.0024
Log (Dir.Inv.Ab.)	0.1175	0.0904	1.3003	0.2099
Log (population)	37.6299	6.6588	5.6512	0.0000

Multiple R-Squared: 0.9787

SWEDEN

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-71.7554	26.7840	-2.6790	0.0159
Log (EXPORT)	-2.0904	3.1802	-0.6573	0.5198
Log (IMPORT)	-0.9015	3.0453	-0.2960	0.7708
Log (GDP. Capita)	-3.8453	3.0483	-1.2615	0.2242
Log (Dir.Inv.Ab.)	0.9621	0.2935	3.2783	0.0044
Log (population)	75.5329	19.5525	3.8631	0.0012

Multiple R-Squared: 0.8728

UNITED KINGDOM

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	75.9233	50.0966	1.5155	0.1470
Log (EXPORT)	-0.5323	0.6381	-0.8341	0.4151
Log (IMPORT)	2.6886	1.3858	1.9401	0.0682
Log (GDP. Capita)	-2.6782	3.5644	-0.7514	0.4621
Log (Dir.Inv.Ab.)	0.7308	0.1523	4.7974	0.0001
Log (population)	-22.5042	17.0834	-1.3173	0.2043

Multiple R-Squared: 0.8854

MALTA

Coefficients:

	Value	Std. Error	t value	Pr(>|t|)
(Intercept)	-146.7307	79.4472	-1.8469	0.0833
Log (EXPORT)	1.1577	1.1392	1.0163	0.3246
Log (IMPORT)	-3.1755	1.2974	-2.4476	0.0263
Log (GDP. Capita)	-1.1680	1.7162	-0.6806	0.5059
Log (Dir.Inv.Ab.)	0.1490	0.1389	1.0722	0.2995
Log (population)	29.4525	15.6998	1.8760	0.0790

Multiple R-Squared: 0.9659

CHINA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-146.7307	79.4472	-1.8469	0.0833
Log (EXPORT)	1.1577	1.1392	1.0163	0.3246
Log (IMPORT)	-3.1755	1.2974	-2.4476	0.0263
Log (GDP. Capita)	-1.1680	1.7162	-0.6806	0.5059
Log (Dir.Inv.Ab.)	0.1490	0.1389	1.0722	0.2995
Log (population)	29.4525	15.6998	1.8760	0.0790

Multiple R-Squared: 0.9659

INDIA

Coefficients:

	Value	Std. Error	t value	Pr (>|t|)
(Intercept)	-179.2820	103.0012	-1.7406	0.1009
Log (EXPORT)	-0.9334	2.0161	-0.4630	0.6496
Log (IMPORT)	7.6871	3.0181	2.5470	0.0215
Log (GDP. Capita)	-23.1947	14.9777	-1.5486	0.1410
Log (Dir.Inv.Ab.)	0.4420	0.2136	2.0692	0.0551
Log (population)	29.7819	24.9329	1.1945	0.2497

Multiple R-Squared: 0.9

FDI Inflow Model	Pr (>| t |)					
Coefficients	Log Exp	Log Imp	Log GDP capita	Log Dir. Inv.	Log Pop	R^2
Austria	0.3278	*0.2877	*0.4149	0.0003	0.0352	0.9154
Belgium	*0.3807	0.1903	*0.1464	0.8306	*0.0761	0.7305
Denmark	*0.2877	0.4504	*0.4149	0.0003	0.0352	0.9154
Finland	0.4629	*0.5557	0.3	0.0016	0.7582	0.9524
France	0.0071	*0.0277	0.1126	0.0538	*0.1552	0.9731
Germany	*0.5195	0.3547	0.067	0.3346	*0.854	0.8418
Ireland	0.556	*0.2656	0.028	0.729	0.0873	0.9098
Italy	0.7551	0.9814	0.162	0.1942	*0.1381	0.7965
Netherland	*0.8792	0.5576	0.0084	0.5325	*0.0303	0.953
Portugal	0.5208	*0.0996	0.0085	0.1722	*0.0139	0.8604
Spain	*0	0	0.0024	0.2099	0	0.9787
Sweden	*0.5198	*0.7708	*0.2242	0.0044	0.0012	0.8728
U.K	*0.4151	0.0682	*0.4621	0.0001	*0.2043	0.8854
India	*0.6496	0.0215	*0.141	0.0551	0.2497	0.9
China	0.3246	0.0263	*0.5059	0.2995	0.079	0.9659
Bulgaria	*0.2098	0.093	*0.0544	*0.8187	*0.0058	0.9692
Cyprus	0.1352	*0.7486	0.7765	0.2853	0.011	0.9352
Czech- Rep	*0.3807	0.1903	*0.1464	*0.8306	*0.0761	0.7305
Estonia	0.399	*0.6415	0.284	*0.3484	0.4593	0.8591
Greece	*0.6808	0.1995	*0.6538	0.2227	*0.2537	0.8454
Hungary	0.1263	*0.0604	*0.4703	0.0548	*0.2589	0.5908
Latvia	*0.2918	0.0842	*0.2142	*0.3751	*0.8017	0.8876
Lithuania	*0.4313	0.3633	0.5261	*0.9669	0.4562	0.7217
Poland	*0.0516	0	*0.0642	*0.1461	0	0.9675
Romania	0.7265	0.9167	*0.2921	*0.1287	*0.5958	0.8443
Slovakia	*0.2552	*0.6451	0.2042	*0.0862	*0.5915	0.8618
Slovenia	0.1351	0.1471	*0.9122	0.8534	0.3789	0.6316
Malta	0.3246	*0.0263	*0.5059	0.2995	0.079	0.9659

* = the star mean that the coefficient value is negative, and that mean, the variable which have this star, make the contrary effect on the FDI Inflow, we can interpreted that as follow, if the variable is significant, so while this variable is go down the FDI go up, and vice versa.

6. 10. 1. 2 - The first economic results:

Economic and Empircal results: From the FDI Inflow Performance Model.

Country	The variables wich more influence.
Austria	the variables which have more influence in our model are Export and population
Denmark	Direct investment abroad and population
Finland	Direct investment abroad
France	Import influence negatively, and the Export influence positively.
Netherlands	GDP per capita has a positive effect; but the population have a negative one.
Portugal	GDP per capita have positive effect. The importation and population have a contrary effect.
Spain	Export influence negatively; import and GDP per capita and Population have a strong influence on the FDI inflow
Sweeden	Strong positive effects for both the Direct investment abroad and Population
United Kigdom	Direct investment abroad and importation
Bulgaria	Importation has a positive effect; but both the GDPper capita and population have a negative one.
Cyprus	Population
Czech Rebuplic	Population has a contrary effect.
Belgium	Population has a negative effect on the FDI Inflow
Germany	GDP per capita
Ireland	GDP per capita and population both have a positive effect
India	Importation and direct investment abroad have a positive effect
China	Both importation and GDP per capita have a contrary relation with FDI Inflow; but the population has a positive one.
Hungary	Positive effect to the Direct investment abroad; and negative one to the importation
Latvia	Importation has positive effect
Poland	The importation and population have a strong influence; but the export has a negative one
Slovakia	Direct investment abroad has a negative effect.
Malta	The population has a positive effect, but the importation has a negative one

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6 .10. 1. 3 - The second empirical results: Cluster Analysis Results:
6.10. 1. 3. 1- the cluster analysis by all the variables in the model.

According to **the FDI Inflow Model**, and its variables to gather we have twelves differ country groups, how the FDI Inflow performance is similar in each group from the twelves one:

1- Austria, Sweden, Ireland
2- Denmark, Poland, India
3- Finland, Czech Republic, Hungary
4- Greece, Portugal
5- Luxembourg Bulgaria Slovenia Lithuania
6- Cyprus, Malta, Latvia, Estonia
7- Slovakia Romania
8- Netherlands, Spain
9- United Kingdom
10- Belgium , Italy
11- France , China
12- Germany

6. 10. 1.3. 2 - Cluster analysis be the single variable FDI Inflow:

Classification of countries group by the variable FDI ***Inflow***: we notice that they are seven groupe whith differ performance:

1- Austria, Portugal, Hungary, India, Finland, Poland, Czech Republic
2- Greece , Cyprus , Estonia, Latvia, Lithuania, Malta, Slovenia, Bulgaria, Slovakia, Romania
3- Italy
4- Denmark, Ireland, 10 New Members ,Sweden
5- Belgium, France, Spain, Netherlands, China
6- Germany, United Kingdom
7- Luxembourg

6.10.1. 3.3 - Cluster analysis by the single variable FDI Outflow.

Classification of countries group by the variable FDI ***Outflow***: we notice that they are five groups whith differ performance

1- Austria; Portugal; China.
2- Greece; Cyprus; Czech Republic; Slovania; Poland; Estonia; Latvia; Romania; Malta; Lithuania; Bulgaria; Slovakia; Hungary; India; Ireland.
3- Denmark; Finland; Italy; Sweden.
4- Belgium; Netherlands; Spain; Germany.
5- France; United Kingdom; Luxemburg.

Conclusion: also here we found that the China performance in Outflow is near the west Europe performance, and the India outflow performance is near the East Europe Outflow performance.

6. 10. 1.3. 4 - Cluster analysis by the single variable Import.

Classification of countries group by the variable ***Import*** we notice that they are … groupe whith differ performance

1- Austria; Sweden.
2- Denmark; Ireland; India; Poland; Finland; Greece; Portugal; Czech Republic; Hungary.
3- Luxemburg; Slovenia; Bulgaria; Cyprus; Malta; Latvia; Estonia; Lithuania; Slovakia; Romania.
4- Belgium; Spain; Netherlands.
5- France; United Kingdom; Italy; China; Germany.

Conclusion: here we have the China Performance is more like Weast Europe; and the India import performance is more like Nord and East Europe.

6. 10. 1.3. 5 - Cluster analysis by the single variable Export.

Classification of countries group by the variable ***Export*** we notice that they are five groups whith differ performance

1- Austria; Denmark; Ireland; Sweden; Spain.
2- Finland; India; Portugal; Czech Republic; Poland; Hungary.
3- Greece; Luxembourg; Slovenia; Romania; United Kingdom; Cyprus; Latvia; Malta; Estonia; Lithuania; Bulgaria.
4- Belgium; Netherlands; France; Italy; China.
5- Germany.

Conclusion: according to the Export variable in the Model we notice that, the China export performance is more like Weast Europe, and the India Export performance is mixed between Nord and East and and few Weast europe countries.

6. 10. 1.3. 6 - Cluster analysis by the single variable Population

Classification of countries group by the variable ***Population*** we notice that they are six groups whith differ performance

1- Austria; Bulgaria; Sweden; Belgium; Portugal; Czech Republic; Hungary; Greece.
2- Denmark; Slovakia; Finland; Ireland; Lithuania; Luxemburg; Cyprus; Estonia; Latvia; Slovenia.
3- Netherlands; Romania.
4- France; Italy; United Kingdom.
5- Spain; Poland; Germany.
6- India; China.

Conclusion: this variable is more important to companies' whcich looking for a huge market.

6. 10. 1.3. 7 - Cluster analysis by the single variable GDP per Capita

Classification of countries group by the variable ***GDO Per Capita*** *we* notice that they are eleven groups whith differ performance

1- Austria; Germany; United Kingdom.
2- Belgium; Netherlands; France; Finland; Italy.
3- Ireland.
4- Denmark; Sweden.
5- Luxemburg.
6- Greece; Cyprus.
7- Malta.
8- Spain.

9- Czech Republic; Hungary.
10- Estonia; Slovakia; Latvia; Lithuania; Poland.
11- Bulgaria; Romania; India; China.

This variable is important indicator to the companies which looking for a rich market.

6. 10. 2 The Enlarged FDI Inflow model 2003

An enlarged model approach with same variables as before, adding the education level and five indicator technological level + six governance indicators. On 2003

> Notice that, the variable Population is too high in India and China we made same analysis twice one without this variable and the second with Population variable, to know the difference and how much it is relevant on the FDI Inflow.

we present the results of FDI enlarged model in three way as follows:

A - Both FDI Inflow and Outflow in Europe 27 with China, India.
B - FDI Inflow & FDI Outflow for EU27 without India, China.
C - FDI Inflow & Outflow for EU 15 with the dataset only in the year 2003.

6.10. 2.1 - FDI Inflow in Europe 27 with China, India

FDI Inflow model 2003 EU 27 + China + India - Pop

FDI Inflow ➔ Export + Import + GDP per c. + Edu level + Tech1 + Tech2 + Tech3 + Tech4 +Tech5 + Gov6

Coefficients:	Value	Std. Error	t value	Pr (> t)
Export	0.0000	0.0000	-0.0043	0.9966
Import	0.0000	0.0000	1.5535	0.1399
GDPc	2.7178	0.7077	3.8402	0.0014
Edu	- 79.3865	145.0234	-0.5474	0.5917
Tech 1	-166.5198	312.6762	-0.5326	0.6017
Tech 2	282.8634	149.9851	1.8859	0.0776
Tech 3	-20.2663	17.6639	-1.1473	0.2681
Tech 4	-3.5506	42.7952	-0.0830	0.9349
Tech 5	11.0542	35.5346	0.3111	0.7598
Gov 6	-25999.1123	8462.3795	-3.0723	0.0073

R-Squared: 0.8610

Results:
Here we notice the strong effect to the six government indicator on the FDI Inflow, then the positive effect to GDP per capita variable.

6.10. 2. 2 - FDI Ouflow in Europe 27 with China, India

FDI Outflow model 2003 EU 27 + China + India – Pop

FDI Outflow ➔ Export + Import + GDP per c. + Edu level + Tech1 + Tech2 + Tech3 + Tech4 +Tech5 + GOV6

	Value	Std. Error	t value	Pr(>ltl)
Export	-0.0001	0.0000	-3.1261	0.0065
Import	0.0002	0.000	3.6100	0.0023
GDPc	2.8420	1.0776	2.6373	0.0179
Edu	-26.5710	220.8137	-0.1203	0.9057
Tech 1	154.8606	476.0831	0.3253	0.7492
Tech 2	81.5408	228.3685	0.3571	0.7257
Tech 3	-31.9801	26.8952	-1.1891	0.2518
Tech 4	14.1325	65.1603	0.2169	0.8310
Tech 5	16.0766	54.1052	0.2971	0.7702
Gov 6	-28319.0912	12884.8835	-2.1979	0.0430

R-Squared: 0.7749

Results: we notice in the Outflow model the strong effect to the Six government indicator on the FDI outflow; also the high positive effect to the export and import and gdp per capita.

6. 10. 2. 3 - FDI Inflow for EU27 without India, China

EU 27 FDI Inflow model 2003 + Pop

Coefficients: Value		Std. Error	t value	Pr(> t)
Export	0.0000	0.0000	-0.4938	0.6297
Import	0.0001	0.0001	1.3859	0.1891
GDPc	2.9627	0.6923	4.2794	0.0009
Pop	-0.2622	0.3549	-0.7388	0.4732
Edu	-208.3442	158.0906	-1.3179	0.2103
Tech 1	-354.6969	313.4258	-1.1317	0.2782
Tech 2	138.0857	169.7879	0.8133	0.4307
Tech 3	-33.2261	18.0739	-1.8384	0.0890
Tech 4	3.46384	3.0766	0.0804	0.9371
Tech 5	7.53123	4.4113	0.2189	0.8302
Gov 6	-24147.3604	8471.8147	-2.8503	0.0136

Multiple R-Squared: 0.8225

Results: here we notice the strong effect of GDP per capita on the FDI Inflow, also to the Government indicator positive effect. Also some technological level indicator as the third one.

6.10. 2. 4 - FDI Outflow for EU27 without India, China

EU 27 FDI Outflow model 2003 + Pop

Coefficients:	Value	Std. Error	t value	Pr(>ltl)
Export	-0.0002	0.0000	-3.4648	0.0042
Import	0.0003	0.0001	3.0713	0.0089
GDPc	3.0283	1.0726	2.8232	0.0144
Pop	-0.9077	0.5498	-1.6508	0.1227
Edu	-243.5557	244.9381	-0.9944	0.3382
Tech 1	24.4865	485.6070	0.0504	0.9606
Tech 2	41.6082	263.0613	0.1582	0.8768
Tech 3	-47.1144	28.0028	-1.6825	0.1163
Tech 4	32.5942	66.7409	0.4884	0.6334
Tech 5	2.8593	53.3153	0.0536	0.9580
Gov 6	-31235.8711	13125.8271	-2.3797	0.0333

Multiple R-Squared: 0.8225

Results:
Here we found the high positive effect to the Export and Import on the Outflow Model.

6. 10. 2. 5 - FDI Inflow for EU 15 with the dataset only in the year 2003

EU 15 FDI Inflow model 2003

Coefficients:	Value	Std. Error	t value	Pr (>ltl)
Export	0.0000	0.0001	-0.5296	0.6493
Import	0.0001	0.0001	1.5077	0.2706
GDPc	4.0873	2.4297	1.6823	0.2345
Pop	-0.7442	0.6674	-1.1151	0.3808
Edu	-540.9074	485.8431	-1.1133	0.3814
Tech 1	1198.2461	1259.7218	0.9512	0.4419
Tech 2	-625.8752	930.4649	-0.6726	0.5705
Tech 3	-50.5816	77.0542	-0.6564	0.5790
Tech 4	-35.7709	70.0112	-0.5109	0.6602
Tech 5	-217.0877	292.7811	-0.7415	0.5357
Gov 6	19275.0528	30703.6388	0.6278	0.5943

Multiple R-Squared: 0.9786

Results:
here we notice that we dont have a particular variable which can explain the FDI Inflow performance, but we can understand that the weast Europe market is in the very developed phase, and the companies think to go more far than Europe, and they did more production in their actuale companies.

6.10.2. 6 - FDI Outflow for EU 15 with the dataset only in the year 2003

EU 15 FDI Outflow model 2003

Coefficients:	Value	Std. Error	t value	Pr(>|t|)
Export	-0.0001	0.0001	-1.6102	0.2486
Import	0.0003	0.0001	2.2993	0.1482
GDPc	6.0418	3 .0240	1.9979	0.1838
Pop	-1.6375	0.8307	-1.9712	0.1875
Edu	-1216.8688	604.6881	-2.0124	0.1818
Tech 1	3589.0516	1567.8700	2.2891	0.1493
Tech 2	-1950.4944	1158.0716	-1.6843	0.2342
Tech 3	-44.3623	95.9028	-0.4626	0.6891
Tech 4	115.1572	87.1371	1.3216	0.3172
Tech 5	-564.3037	364.4001	-1.5486	0.2616
Gov 6	29912.8333	38214.2427	0.7828	0.5157

Multiple R-Squared: 0.9969

also to the Weast Europe Outflow, we notice that there is not a strong variable indicator, but we can notice the light effect to the Import level and education and technological level.

Conclusion

- India is more similar to the East & North Europe countries. (EU 12)
- China is more similar to the West Europe counties.(EU 15)
- Same variables have different effect on each single Europe country.
- The variable export, either the Import, has more effect on the FDI Inflow.
- The variable Population is more important when the firm look for a huge market, but the GDP per capita is more important when the firm look for a rich one.

6.10. 3 - Future reserch development: going with more technique and specify cluster analysis, using more Deeping Diana technique and regressions model with SPLUS, to know how far each countries group to each other? And why? And what are the meanings of these distances? To know what are exactly the Micro and Macro economic factors which influence more on each coutry group?

Then to make the same analysis on other economic group like G8… to foresee the FDI trend to short and middle and long term

APPENDICES 1

A selection of internationalization models

Rogers (1962) 1. Awareness of an innovation: the individual is exposed to it. 2. Interest: the individual seeks more information. 3. Evaluation: the individual applies information to his/her situation. 4. Trial: the individual uses innovation on a small scale. 5. Adoption: the individual makes full use of the innovation.
Luostarinen (1970) 1. The starting phase of exporting operations. 2. The development —"—. 3. The mature —"—. 4. The starting phase of foreign operations. 5. The development —"—. 6. The mature —"—. 7. The phase of international operations: domestic operations decrease. 8. The phase of international firm: the firm has no home country.
Wind, Douglas and Perlmutter (1973) 1. Home country orientation (ethnocentrism): overseas operations are secondary to domestic operations. Their volume is insignificant. 2. Host country orientation (polycentrism): subsidiaries are established in overseas markets. 3. A regional orientation (regiocentrism): the company views the entire region as a potential market. 4. A world orientation (geocentrism): the firm views the entire world as a potential market.
Johanson and Wiedersheim-Paul (1975) No regular export activities → export via overseas agents → establishment of an overseas sales subsidiary → overseas production/ manufacturing.
Pavord and Bogart (1975) 1. No international activity. 2. Passive activity: the firm does not seek foreign orders but will accept unsolicited orders. 3. Minor activity: occasional soliciting of foreign orders. 4. Aggressive activity: the firm is continuously involved in soliciting of foreign orders.
Bilkey and Tesar (1977) 1. The management is not interested in exporting; it would not even fill an unsolicited export order. 2. —"— is willing to fill unsolicited orders, but makes no effort to explore the feasibility of active exporting. 3. *(Can be skipped if unsolicited export orders are received)* The company actively explores the feasibility of exporting. 4. The firm exports on an experimental basis to some psychologically close country. 5. The firm is an experienced exporter to that country and adjusts exports optimally to changing exchange rates, tariffs, etc. 6. The management explores the feasibility of exporting to other countries that are psychologically further away.
Wiedersheim-Paul, Olson and Welch (1978)

1. Domestic firm: no or low willingness to start exporting, no or low information collecting, no or low information transmission. 2. Passive non-exporter: low to medium willingness to start exporting, low to medium information collecting, low information transmission. 3. Active non-exporter: medium to high willingness to start exporting, medium to high information collecting, low to high information transmission. 4. Exporter. *The authors do not directly point out to this stage.*
Bilkey (1978) Gaining basic export experience → exporting to psychologically close markets → moving to the next close market → concentrating on the most attractive markets and developing them in depth: for example, opening foreign production facilities.
Khan (1978) New exporters' market ventures → buyer initiated export market ventures → unplanned export market ventures → carefully planned export market ventures → experienced exporters' market ventures → exports through own sales subsidiary → export ventures located in Communist countries.
Luostarinen (1979) 1. Non-investment marketing operations — direct or indirect exports. 2. Direct investment-marketing operations — sales or marketing subsidiaries. 3. Non-investment production operations — licensing or contract manufacturing. 4. Direct investment production operation — production subsidiary. *Firms can skip some or all of the first three stages or not reach the last ones.*
Cavusgil (1980); Gankema, Snuff and Zwart (2000) 1. Domestic marketing. The firm sells only to the home market. It is not interested or willing to experiment with exporting at all. The export/sales ratio is 0. 2. Pre-export stage. —"— searches for information and evaluates the feasibility of undertaking exporting. However, basic information about costs, exchange risks, distribution, etc. is still lacking. The export/sales ratio is at or near 0. 3. Experimental involvement. —"— starts exporting on a limited basis to some psychologically close country. The export/sales ratio varies between 0-9 percent. 4. Active involvement. There is a systematic effort to increase sales through export to multiple countries. A suitable organizational structure is in place to support these activities. The export/sales ratio varies between 10-39%. 5. Committed involvement. The firm depends heavily on foreign markets. The managers are continuously faced with choices for the allocation of limited resources to either domestic or foreign markets. Many firms are engaged in licensing arrangements or direct investments. The export/sales ratio is 40% or more.
Reid (1981) 1. Export awareness. Low opportunity recognition, low need for exporting. 2. Export intention. Motivation, attitude, beliefs and expectancy about export contribution. 3. Export trial. Personal experience from limited exporting. 4. Export evaluation. Results from engaging in exporting. 5. Export acceptance. Adoption of exporting/ rejection of exporting.

Wortzel and Wortzel (1981) 1. Importer pull: foreign customer's orders. 2. Basic production capacity marketing. 3. Advanced production capacity marketing. 4. Product marketing — channel push. 5. Product marketing — consumer pull.
Czinkota and Johnston (1981) The unwilling → the uninterested → the interested → the experimenting firm → the semi-experienced small exporter → the experienced large exporter.
Czinkota (1982) 1. The completely uninterested firm: no exploration of feasibility to export. 2. The partially interested firm. Exporting is a desirable but uncertain activity. 3. The exploring firm. Planning for export and actively exploring export possibilities. 4. The experimental firm. Favorable export attitude but little exploitation of exporting possibilities. 5. The semi-experienced small exporter. Favorable attitude and active involvement in exporting. 6. The experienced large exporter. Very favorable export attitude and future export plans.
Cavusgil (1982) 1. Non-exporting firms, not interested in gathering export-related information. 2. Non-exporting firms, interested in gathering export-related information. 3. Exporting firms. Export less than 10% of their output. 4. Exporting firms. Export more than 10% of their output.
Reid (1983) 1. Occasional exporting: directly to a buyer. Low exports per turnover. 2. Indirect exporting via agents, manufacturing representatives, commission agents. Low exports per turnover. 3. Indirect exporting via foreign distributors. Low- medium exports per turnover. 4. Direct exporting. Medium- high exports per turnover. 5. Formal export department: using both direct and indirect exporting. High exports per turnover. 6. Foreign sales subsidiary. High exports per turnover. 7. Foreign manufacturing. Low exports per turnover. 8. Licensing. Low exports per turnover.
Cavusgil (1984) 1. No exports. 2. Experimental involvement: the firm initiates restricted export marketing activity. 3. Active involvement: the firm systematically explores a range of export market opportunities. 4. Committed involvement: the firm allocates its resources on the basis of international marketing opportunities.
Barrett and Wilkinson (1985) 1. Non-exporters who never consider exporting. 2-3. Non-exporters who investigate exporting. Previous exporters. 4. Current exporters with no direct investment abroad.

Vozikis and Mescon (1985); Chetty (1999) 1a. The firm does not explore the feasibility of regular exporting. 1b. —"— fills unsolicited export orders (if any). 2a. —"— explores the feasibility of regular exporting. 2b. —"— fills exports experimentally to one or few markets. 3a. —"— is an experienced exporter to some markets. 3b. —"— explores possibilities of exporting to additional markets.
Moon and Lee (1990) Lower stage → middle stage → higher stage of export expansion.
Lim, Sharkey and Kim (1991) 1. Awareness. Information search on export opportunities. 2. Interest in selecting exporting as a viable strategy. 3. Intention. Beginning to export. 4. Trial and adoption. Export intensity/status of firm with regard to export.
Rao and Naidu (1992) 1. Non-exporters. No current level of export activity, no future interest. 2. Export intenders. Current non-exporters, but would like to explore export opportunities. 3. Sporadic exporters. Exporting on a sporadic basis. 4. Regular exporters. Exporting on a regular basis.
Bamberger and Evers (1993) 1. Domestically-oriented firms: no present international activities and no interest in starting export activities in the near future. 2. Pre-involvement stage: firms do not have international operations but envisage the possibility of starting such operations in the near future. 3. Reactive involvement: the firm's total export turnover is still low and there are no explicit long-term objectives and plans concerning it. 4. Active involvement: expansion of export volume and establishment of other kinds of foreign operations. 5. Committed involvement: international activities are a permanent and integrated part of the firm's business; the proportion of turnover generated abroad becomes an essential component of total turnover.
Luostarinen (1994) The domestic → the inward → the outward → the cooperative stage.
Crick (1995) 1. Completely uninterested firm. 2. Partially interested firm. It has marketing and profit advantage, managerial urge and unique products. 3. Exporting firm: marketing and profit advantage and managerial urge. 4. Experimental exporter: marketing and profit advantage, managerial urge and competitive pressures. 5. Experienced small exporter: marketing and profit advantage and managerial urge. 6. Experienced large exporter. The firm has managerial urge, unique products and profit advantage and, to a lesser extent, competitive pressures and marketing advantage.

Leonidou and Katsikeas (1996) 1. The pre-engagement phase. Firms sell their goods solely in the domestic market. 2. The initial phase. —"— are involved in sporadic export activities. 3. The advanced phase. —"— are regular exporters with extensive overseas experience and frequently consider more committed forms of international business.
Buckley (1996) Home activities only → direct exporting → foreign agent → foreign sales subsidiary → foreign production subsidiary *Skipping some stages is also possible.*
Pauwels and Matthyssens (1999) 1. Initial and accumulating market commitment: performance does not continue to materialize as expected, although companies increase their market commitment. 2. Increasing stress as an immediate consequence of the perceived ineffectiveness of the tactical responses. 3. Two opposite reactions: either increasing commitment to the particular venture or searching strategic alternatives. 4. Toward a stress threshold: increasing stress, a catalytic incident may act as a final straw to the export withdrawal. 5. Confrontation at the threshold: the accumulation of stress reaches a threshold at which the export withdrawal is decided. 6. Learning beyond the withdrawal: a firm's degree of internationalization may even increase.
Lundan and Hagedoorn (2001) Domestic mergers → initial foreign production via "greenfield" investment → joint ventures and minority investments → knowledge- seeking mergers and strategic alliances.
Knight and Liesch (2002) 1. The management encounters a trigger alerting it to an internationalization opportunity (for example, elimination of trade barriers or an unsolicited export order). 2. —"— is alerted to an internationalization opportunity. 3. —"— launches an information search. 4. —"— transforms internationalization information into knowledge within the firm. 5. —"— becomes informed on internationalization. 6. —"— becomes ready for internationalization. 7. The firm internationalizes.
Freeman (2002) International awareness → interest → trial → adoption

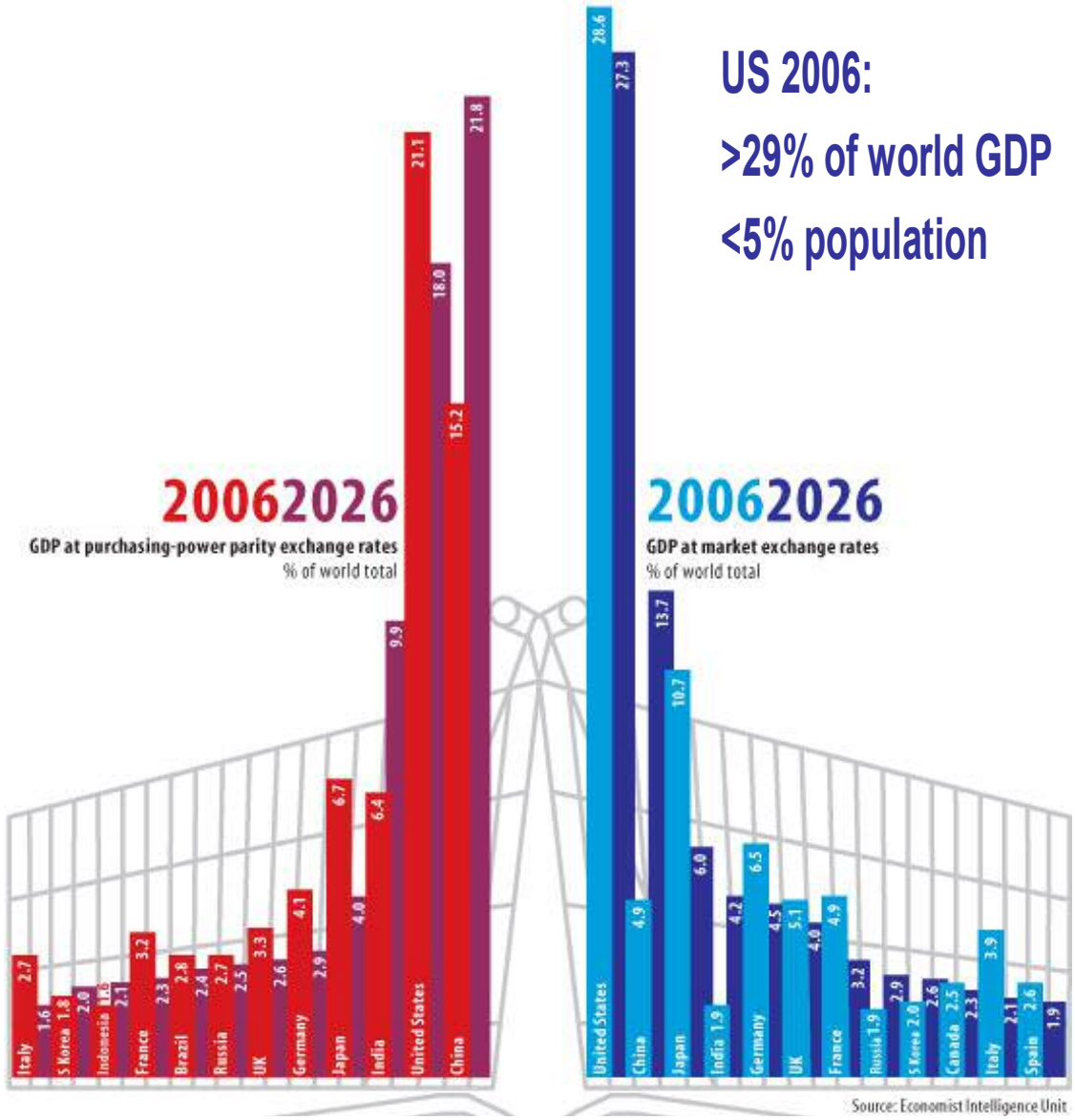
Appendix 2

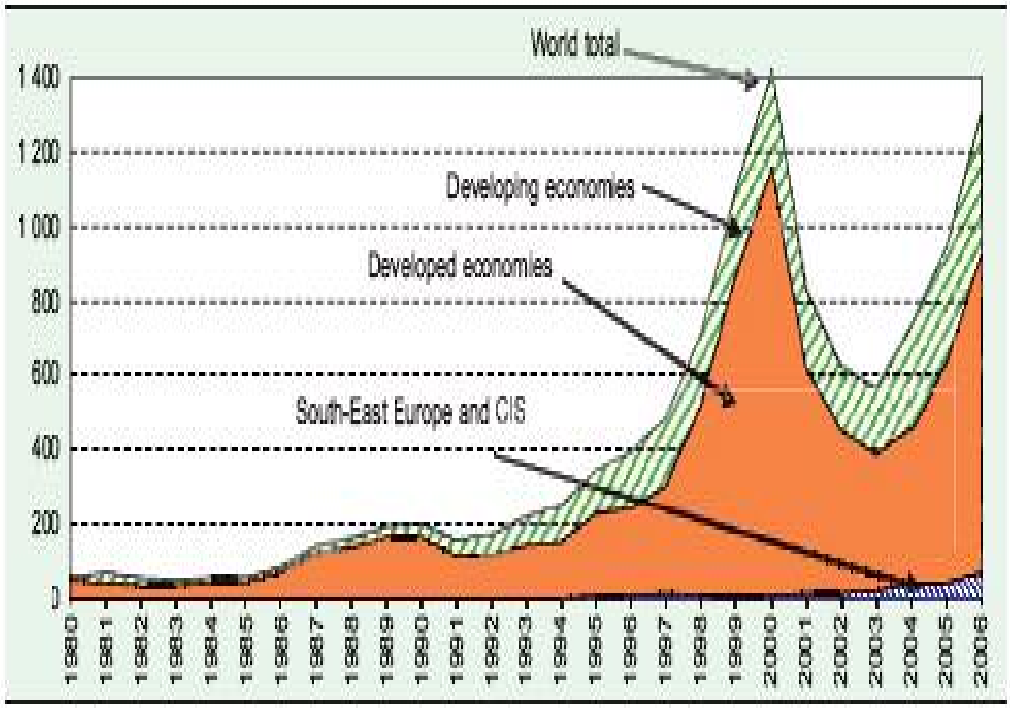
-Assessment of existing models and theories on market entry mode choice

Basic models	*References*	*Theory applied*	*Main arguments*	*Limitations*
SD model	Johanson and Paul (1975); Brooke (1986); Young et al. (1989)	Firm theory	Internationalization of SMEs is a long, slow and incremental process of cultural and geographical expansion and commitment.	Can not explain why some newly established firms start operation in foreign markets with high equity entry mode, such as foreign direct investment.
TCA model and extensions	Anderson and Gatignon (1986); Hill et al. (1990); Klein et al. (1990); Erramilli and Rao (1993)	Transaction cost theory, institution theory, and some others	Efficiency maximizing firms adopt entry modes which minimize transaction costs.	Measurement proves to be difficult, and there is no connection with corporate governance.
OLI model	Dunning (1977, 1980, 1988, 1995, 1998, and 2000)	International production theory, organization theory, internalization theory, location theory, and some others	The choice of market entry mode is determined by three sets of advantages: ownership, location and internalization advantage. The more advantages a firm possesses the more likely it adopts a high equity entry mode.	The static model ignores the impact of the firm objective, the decision maker, and the situational contingency surrounding the decision maker when the entry mode choice decision is made.
OC model	Aulakh and Kotabe (1997); Madhok (1998)	Organization theory	Entry mode decision depends on the deployment and the development of firm capacity.	Firm capacity is not limited to ownership boundaries and it is not justifiable to ignore both the decision maker and the social and political environment.
DMP model	Root (1994); Young et al. (1989); Kumar and Subramaniam (1997)	Behavior theory, contingency theory, and some others	Entry mode choice is regarded as a multi-stage decision making process taking into consideration some important factors.	Ignores the impact of the organization efficiency and the decision maker.

Sources: Bilkey 1978; Bilkey and Tesar 1977; Calof and Viviers 1995; Cavusgil 1984; Krugman 2000

World Economies 20 Years From Now





Source: UNCTAD, based on annex table B.1 and FDI/TNC database (www.unctad.org/fdi statistics).

FDI inflow by group of economies,Trend 1980-2006

Acronyms

- ANIMA: Euro-Mediterranean Network of Investment Promotion Agencies
- CEEC: Central and Eastern European Countries
- IPA: Investment Promotion Agency
- FDI Foreign Direct Investment
•MEDA: group of 12 partner countries of the EU: Algeria, Cyprus,Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Palestinian Authority, Syria, Tunisia, Turkey
- MIPO: Mediterranean Investment Project Observatory (ANIMA)

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81-World investment bank reports (from 1991 to 2007)
82 - World economic situation and prospects (several reports)

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Nationality: Syrian
Language: Arabic (Native), English (Fluent), Italian (Fluent)
, French (average) Deutch (basic)
University degrees: - Degree in international Law in Aleppo university / Syria 1999
- Degree MBA (General Management) March 2003 – July 2004 (Politecnico di Milano)
- PhD student 2005 – 2007
The technology economic & management
(Milan & Turin & Bergamo University)

Objective:

To link My continues Improvement in Managerial knowledge and skills
With cultural and social experience to create Value for the company and to enhance my personal capabilities.

Education:

-October 2005 – January 2008 Economic and Technology Management course PhD
- March 2003 – May 2004:Master in Business Administration MBA at MIP 24 'School of Business' Politecnico di Milano, Milan / Italy.

- 2000 – 2001 Master **of International Relationships 2000 -2001**
Damascus University
- 1992 – 1998 University: degree from University of Aleppo, Study in Law; specialised in international law and international conflict law.
1983 – 1990 High School / College: College de la fraternité: scientific field main of study Physics, Chemistry, Mathematics.

Job history:

2003 – 2005 Consulting company Between Syria – Dubai – Abu Dhabi – Kuwait (Construction, Medical Equipment, Agriculture, Financing services, Tourism, breeding animals)
Mini stage: Lucent Technology Milan: Mapping purchasing process, find
1 criticalities and elaborate plan of action. Cum laude.
02/2004- 05/2004 : Project work: **MANULI RUBBER S.p.A, (www.manulirubber.com) – Brugherio (MI),** (Hydraulic sector): Marketing department building a customer satisfaction tree and definition for the 'tableau du bord' to evaluate and rank costumers of the hydraulic sector.

- 1999 - 2003: Service industry (Shipping, transportation, logistics): AMENA TOURS Company Aleppo / Syria; Vice president Manager in operations and logistics responsible for fourteen cities in Syria.
- 1998 – 1999:Food industry: DOLIZE Company Damascus / Syria: Marketing manager responsible for Syria.
Middle East (pasta brand): Purchasing manger and cost accounting responsible for Syria.
- 1994 - 1998: Import – Export Industry: KATACH General Trade, Aleppo: Family-owned business: Responsible for purchasing, responsible for legal aspects and responsible for accounting in addition hold the position of the vice-president of the company. As all the banks were governmental they acted as partners for all import / export activities (e.g. complex trade balance concerning value export towards import – limitation in value and type of imported goods, authorisation given by governmental body).

Additional work experience:
Experience in Purchasing and Operation field in Construction Industry (Project manager, Cost accounting and bid and trade process); Agriculture (Project manger, cost accounting); Leather Industry (purchasing manager of raw material).

Personal:
Interests: Travelling, biking, table tennis, chess, languages (currently learning Russian, Turkish and Spanish), Nature and animals (in particular tropical animals)

Membership: Member of Syndicate of Law in Aleppo (approved); Member of Arabic Law Syndicate (in approval state)
Computer Skills: Microsoft Office programs & Matlab. PC Gave. Splus

Conferences & Workshops:
-TRIPLE HELIX 5 "the capitalization of knowledge: the cognitive, economic, social & cultural aspects" Turin 18- 21 maggio 2005
- il seminario di studi "diritti di propieta' intellettuale tra incentivi e strategie problemi di ricerca e casi di studi" 17 giugno 2005 torino Fondazione Giovanni Agnelli

- International workshop "bridging the gap: the role of trade FDI in the Mediterranean" Naples 8 – 9 Giugno 2006

WorkShop della società Italiana di Economia e Politica industriale (SIEPI)
- "ECONOMIA INDUSTRIALE E INNOVAZIONE : ASPETTI TEORICI E POLITICHE " - Bologna 26 - 27 gennaio 2006.
Conferenza "Laboratorio Euro- Mediterraneo" con la Camera Commercio di Milano "Sostenere lo sviluppo, formare la conoscenza, comunicare le differenze: la sfida mediterranea e il ruolo dell' Italia"
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Personal characters

I can't stop myself to learn more (at all directions) Continus Improvmet Strategic.
I like the challenge.
I believe that always the companies can do more by reusing the same resources (human, Capital, Customers, & its suppliers...) in other way
I Belive that the University can make better the society on each the Micro and Macro economic aspects.

Milan, 29 January 2008

Remark of Italy:

"I authorize the use of this resume for data processing aimed at developing potential future employment opportunities, according to Italian law D.L. 196/2003."