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**GLOBALIZATION AND ECONOMIC INTEGRATION – WHAT
CHALLENGES ECONOMIES IN TRANSITION?**

Summary:

The aim of this discussion paper is to assess the significance and meaning of the globalization of markets and international production for the competitive advantage of nations or certain market areas. Another purpose is to look at the concept of economic integration and what role there is for companies, nations or certain regions in this concept. The focus of the study is on developing or transition economies and their economic development stage, i.e. how globalization and economic integration of markets affect their situation, market position and determinants of economic welfare. Finally, the study considers the challenges that globalization and economic integration put on the industrial and economic policies of economies in transition.

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1. Introduction

Economic globalization and economic integration are unquestionably some of the strongest and most visible development trends in the current world economy. Globalization and an increasing amount of international production, internationalization in general, as well as fast technology transfer and international economic networking are seen to unite different markets so that they become more and more interdependent. On the other hand, economic integration is seen as one way to enhance the competitiveness of countries. Mentioned phenomena in hand are, however, far from being simple, since the concepts of globalization and integration are often not clarified enough. However, these concepts are used almost daily in political and economic discussion and there is a lot of confusion related to their redundant meaning. This is mainly because of the mixed use of different concepts by entrepreneurs, scholars, and policy makers. In addition, it is not always clearly defined whether these terms refer to regions, nations, industries or single firms.

The purpose of this paper is to remove some vagueness concerning the concepts of globalization and integration, and discuss their effects on the economic development of countries. Special emphasis is put on considering these matters from the viewpoint of economies in transition and developing economies and markets.

The aim of this paper is to find answers to the following questions:

- a) Do globalization of economic activity and international production affect the competitive advantages of individual countries?
- b) What does economic integration of markets really mean and what role is there for companies, countries and regions?
- c) Do globalization and economic integration of markets have effect on the determinants of a country's economic wellbeing and development?
- d) What do these above-mentioned questions indicate for economic and industrial policy?

2. What is the nature of economic globalization and what does it mean for the competitiveness of countries?

The liberalization of world trade and unification of foreign trade systems all over the world, as well as increasing internationalization have led us to increasingly discuss globalization. Economic globalization means that international business operates on a global level. This can be seen as greater and deeper interdependence between countries that participate in world trade. Also, when the geographical area in which international business operates and when business operation modes increase they deepen the interdependencies between different economic actors. These actors are companies, organizations and countries (Dunning, 1997).

Central factors through which globalization develops are (Väyrynen,1998):

- Increase of international trade
- Liberalization of capital markets
- Growth of the amount of foreign direct investment, which exceeds even the growth of foreign trade
- Expansion of technology in such a manner that (especially through information technology) meaning of physical distance in many operation modes decrease.

One of the most important signs of global economy is *interdependence*, which has meant development of an international network economy. Growth of the world economy as well as fast development of information technology has accelerated this network of economies. A typical feature for networking and interdependent economies is specialization, which has itself increased companies' and enterprises' dependencies on other companies', especially related and supporting industries.

According to Dunning (1997) companies see these changes and shifts, which have led to globalization in the world economy in the following ways:

- Globalization increases the need to take advantage of opportunities offered by international markets.
- Fierce competition puts pressure on companies to acquire factors of production (raw materials, components etc.) from the cheapest sources available.
- Integration of markets increases foreign direct investments looking for an effective operational environment.
- Globalization increases international communication and makes it more effective. It also lowers transportation costs.
- Globalization has a tendency to enhance oligopolistic competition between leading international companies.
- Globalization opens up new location options for foreign direct investments.
- Globalization increases companies' needs to take advantage of foreign technology and know-how as well as to exploit the benefits of a geographical concentration of their operations.
- Globalization develops new possibilities to establish new strategic alliances between foreign companies.
- Globalization also means shifts in the importance of various location-specific advantages.
- Globalization makes it inevitable to find a better balance between the globalization of entrepreneurship and that of a local business environment.

Although at the moment a true globalization mainly concerns multinational companies and well-developed, big market economies, it is obvious that small, open economies or even transition economies can not keep themselves out of this development. Out of necessity they are becoming part of the international trading systems and international chains of production. At the same time they should find their role in the international division of labor and production.

All in all globalization has had a fundamental effect on shifts in thinking and explaining international economics, especially international trade and production. Traditionally, the mainstream theories of international trade have relied on the Hechsher-Ohlin theory of

comparative advantage in explaining international trade and its benefits to participating countries¹. On the other hand, in international business the ultimate theory of explanation for international trade and international production has been the *competitive advantage* based on companies' and industries' abilities to create competitiveness at home as well as in international markets².

The above-mentioned factors accelerating globalization, like changes and development in high-technology, increasing internationalization, liberalization of international trade and the growing amount of international investment have led us to a situation where location of production depends much less on the basic factors of production (i.e. natural resources, capital, labor) indicated by theories based on comparative advantage. Instead location of production is more dependent on company-specific, competition-related factors and the advantages created by companies themselves (i.e. entrepreneurship, innovations, knowledge, skills, technology, organization culture).

However, a certain part of the companies' functions is still based on so-called country-specific matters. This is sometimes called H-O based production to show the difference with Schumpeterian-based production, which refers to fast-growing innovative (created inside companies) know-how-based production³.

¹ According to this theory countries' underlying characteristics shape the pattern of trade. Countries tend to export goods that intensively use their relatively abundant factors, i.e. countries with highly skilled work force tend to export goods that require skill-intensive production, countries with abundant land and climate export agricultural products etc. However, empirical evidence since the Second World War has shown that world trade has changed to consist of exchanges that cannot be attributed easily to the underlying advantages of the countries that export particular goods. The most famous empirical evidence challenging this conventional trade theory has been that of Leontief (1953).

² Competitive advantage is never identified at the level of a national economy, but at the level of individual companies and industries. When one refers to the competitive advantage of a country, they refer to the specific industries, because no national economy has gained competitive advantage in all economic sectors at the same time compared to other economies. Moreover, in most cases competitive advantage pertains to groups of industries that are linked together by horizontal or vertical interdependencies. International competitiveness is usually (and in this paper) defined as export competitiveness of national industries.

³ Division of production into these two categories is related to companies' competition factors, which are essential when companies compete in international markets. Companies, who use an H-O -based production, do not cross too many borders between countries (e.g. mining). On the other hand Schumpeterian-related production is based more on R&D-functions and innovations than H-O-based companies on average (e.g. the telecommunication sector). Division of companies in to these two categories is not simple, because fast and flexible production and well-developed final products are important to all kind of companies (see S aynevirta and Yl -Anttila 1996).

Different kinds of industries are usually divided according to their location-specific factors into three different categories. These are: (1) *factor-seeking*; (2) *market-seeking*; and (3) *footloose production*.

Factor seeking production is looking for production possibilities near sources of raw material or energy. This is very typical for the primary sector, but it is also common for some higher-level production processes.

Market-seeking production seeks demand for final products. Production according to market demand is very typical for well-developed final products. But also the role of transportation costs is meaningful for products belonging to this group.

The third group, namely, footloose production, is somewhere in between the two previous extremes. The level of production of these goods is usually medium-stage. The determination of location in footloose-based production is a much more complicated process than in factor- and market-seeking productions, and companies react to factors that influence the attractiveness of a location much more easily than in other two cases.

Globalization lessens the relative share of factor- and market-seeking production. Globalization and networks of international production need plenty of intermediate products and services related to them. Location in these cases is not so important on the grounds of distances, but on the grounds of production circumstances. This refers to infrastructure, transport connections and the flexibility to unite different kinds of production processes.

From the point of view of globalization and the development of regions, it is important to consider what explains the mobility of factors of production and the decision processes of companies in international production and foreign direct investments.

J.H. Dunning (1993) has created a theory of the so-called OLI- paradigm or eclectic paradigm. According to this theory the desire of companies to move their production

abroad is born when a company has certain advantages (ownership specific advantages) that its competitors do not have. O-advantages are thus company-specific advantages. O-advantages primarily take the form of intangible assets or of the advantages of common governance, which are at least for a period of time, exclusive or specific to the firm possessing them. A firm is reaching for o-advantages to overcome a threshold, which it always has, to some extent, when operating in foreign markets, but which do not confront local companies (i.e. domestic companies).

In addition to possessing these o-advantages, it must be more beneficial for the firm to use them (or their output) alone rather than to sell or lease them to foreign firms: this it does through an extension of its existing value-added chains or the adding of new ones. These advantages are called internalization advantages.

If an enterprise has these two above-mentioned advantages it also has to be in the global interest of the enterprise to utilize these advantages in conjunction with at least some factor inputs (including natural resources) outside its home country; otherwise foreign markets would be served entirely by exports and domestic markets by domestic production. These advantages are termed the location-specific (L) advantages of countries.

According to Dunning, the greater the o-advantages of enterprises the more incentive they have to utilize them. The more the economics of production and marketing favor a foreign location, the more likely companies are to engage in foreign direct investment. Thus, the propensity of a certain country to participate in international production is dependent on the extent to which its enterprises possess these advantages and the locational attractions of its endowments compared to those offered by other countries or regions.

As can be seen the OLI-paradigm does not make any priori predictions, about which countries, industries or enterprises are most likely to engage in foreign production. What the paradigm says, however, is that the advantages will not be evenly distributed across

countries, industries and companies. Furthermore, it says that advantages interact with each other and that their significance and structure may change over time.

In this context it is also useful to consider a country's international competitive position in the multinationalization process. Now, companies, which possess net ownership advantages vis-à-vis rival companies are looking for internationally competitive countries or regions in which to establish their production facilities. Consequently, countries and regions are termed competitive according to their prevailing conditions.

Countries can be competitive also in another way. Conditions in a country may be such that they actually stimulate competitiveness. Dunning (1979) has suggested that there really is a close connection between the ownership advantages of companies and some specific characteristics of countries. It is argued that these characteristics stimulate and maintain the technological advantages of companies located within the boundaries of the country. These characteristics include among others the availability of good educational and training facilities coupled with the supply of skilled manpower, technicians and managers; good and reliable capital markets; government-provided investment - R&D incentives and industrial policy; and high per capita incomes together with high income elasticities of demand.

A country possessing, as well as developing and sustaining, these technological advantages can be named 'entrepreneurially competitive'. Technological advantages form specific intangible assets, which are internalized and centralized within companies. To be able to take advantage of these assets fully, companies will undertake substantial foreign direct investments and become increasingly transnational in nature.

It should be emphasized that not all country characteristics fit into this kind of simple classification. Many features important with respect to entrepreneurial competitiveness also improve the locational attractiveness of the country. However, it is the difference in the weight of these country features and characteristics in the multivariate measurement of both dimensions of competitiveness that is essential.

The following figure, by Sleuwaegen (1988), is obtained by, the basic foreign investment conditions combined with the proposed taxonomy:

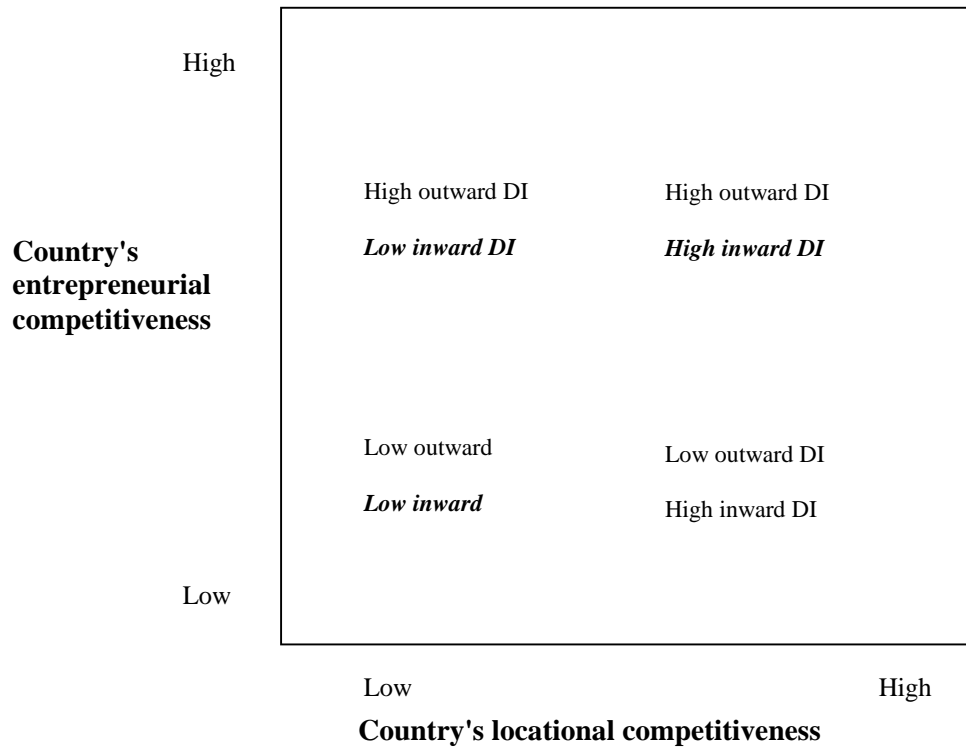


Figure 1. Country's competitiveness and direct investment (DI) flows

Thus countries that are entrepreneurially and locationally attractive display a high degree of attraction for direct investment, displaying high outward and inward direct investment flows. Countries that score better on the locational dimension than on the entrepreneurial dimension will show an imbalance with relatively more inward than outward direct investment (see figure 1). That is why the combination of entrepreneurial and locational competitiveness explains a country's net direct investment flows. Consequently, as countries change in one of these competitiveness dimensions their net direct investment balances also change.

However, one has to keep in mind that in the evolution of truly global competition not only production facilities but also other functions within the firm are geographically

dispersed and decentralized. Thus a country exhibiting strong entrepreneurial competitiveness could attract global competitors benefiting from the mentioned technological advantages to perform their R&D activities in that country. This results in international companies operating as global networks and entailing larger flows of inward DI in entrepreneurially competitive countries. However, these theoretical considerations have not been satisfactorily studied empirically and those results may reduce the explanatory power of figure 1.

As discussed, countries and regions offer various facilities for production, business life and international companies. Economic actors create economic growth, employment and welfare. That is why a regions' abilities to answer to the challenges of globalization (positive or negative effects) and mobilization of factors of production across national borders are essential for their success and economic wellbeing.

So it is obvious that the actions of companies that practice business in many countries and the role of the foreign direct investments have essential parts in building and reconstructing different industries in host countries⁴. This is especially true for economies which are seriously and thoroughly developing their industrial and economic functions, like many transition countries in Eastern Europe (Ozawa, 1996; Borsos and Erkkilä, 1996). The openness of markets and creations of possibilities for international business with the companies of more developed countries are thus one of the key questions for increasing welfare and industrial dynamism in transition countries (Ozawa, 1996).

⁴ The contribution of FDI not only comprises offering financial resources, bringing in new technology and marketing knowledge and management, but also access to foreign markets.

3. Traditional versus new concepts of economic integration of markets – what is the role of different economic actors?

One central part of the current development in international markets is the integration process of markets belonging to different regions or countries. In the European context this is especially visible in the deepening and enlargement process of the European Union. In economics integration is traditionally seen as highly institutional development, which requires that participating countries have fairly high and similar levels of development (see, for example, Robson 1987). Economic integration is divided into stages depending on how far the member states have advanced in cutting down barriers impeding economic activity among each other and how far the implementation of common policies has advanced. Balassa (1976) has named certain traditional stages of economic integration. These are a free trade area, customs union, common market, economic union and full economic union (see table 1).

Table 1. Traditional stages of economic integration

	No tariffs or quotas	Common external tariffs	Free flow of factors	Harmonized economic policies	Unification of political institutions
Free Trade Area	X				
Customs union	X	X			
Common market	X	X	X		
Economic union	X	X	X	X	
Total economic integration	X	X	X	X	X

Source: Balassa 1976

Balassa also makes a difference between certain types of integration, namely: (1) *trade integration*, which means removing barriers; (2) *factor integration*, which refers to liberalization of factor movements; (3) *policy integration* consisting of harmonization of

economic policies; and (4) *total integration*, i.e. complete unification of the policies of participating countries.

According to Tinbergen (1965) economic integration includes two major elements. They are removal of barriers from economic activity of member states, i.e. *negative integration*; and *positive integration*, which refers to the creation of new supranational institutions for securing the optimal functioning of an integration arrangement.

Economic integration is also divided into the concepts of *formal integration* and *true integration*. The former is defined as a formal agreement of certain states to either remove barriers from their economic activity or to create new supranational organizations. This means that formal integration can be either negative or positive integration by nature. The latter, i.e. true economic integration, can occur even without any formal agreements. Instead economic integration is based on increasing trade and investment flows among certain nations and, due to this, economies become more interdependent. Thus true economic integration is mainly dependent on the behaviour of economic agents and their strategic decisions.

As true economic integration and globalization development is pervasive strongly raising its head in the current development of the World economy, the role of countries and states in the economic field has been declining. Economic decision making and power have been devolving downwards to subnational units. At the same time some part of this power has also moved upwards to multiregional organizations (like the EU) due to formal integration (Strange, 1996).

This kind of development is leading the international economy towards increasing regionalization, which is not only because of the rise of economic blocs like the EU, but also because of the rise of the much more complex and multidimensional processes and transnational formation of regions⁵. Multinational and transnational regions may cross

⁵ Integration of states certainly puts framework and incentives for possibilities for regional economic integration or co-operation, which is the reason why they should often be considered together (See Inotai, 1998)

the borders of different countries and national territories, but they are not necessarily inclusive of the whole area of a country, but more likely only subregions belonging to various countries. One example of this is the Baltic Sea Economic region, which covers not only entire countries such as Finland, Estonia, Latvia, Lithuania etc., but also parts of countries, such as the northern part of Germany, St. Petersburg and the Leningrad area as well as the Kaliningrad region belonging to the Russian Federation (see, for example, Kivikari 1998).

Traditional analysis of the effects of economic integration in today's world is rather limited when it is based on trade creation and trade diversion effects⁶. Also, ruling customs union theory sees markets as perfectly competitive. However, the existence of multinational and transnational companies implies that imperfect competition has to be considered when analyzing real world situations empirically. The assumption of immobile factors of production is also no longer valid for empirical purposes (Sachwald 1994).

Newer models and theories of economic integration are based on less restrictive assumptions than many mainstream models of economics. For example, Robson (1993) goes beyond traditional approaches in his analysis of economic integration in at least three ways. Factors' movements are included, coordinated use of national policy instruments are included and integration is considered by more criteria than efficiency in resource allocation alone.

Dunning and Robson (1988) have also thought about internationalization and globalization from the perspective of company level, as well as country level, motives. This is interesting because only a few attempts have been made to combine the causes and effects of the international integration of activities by and within multinational

⁶ According to customs union theory the creation of customs union will lead to trade creation and trade diversion. Trade creation occurs when domestic production is replaced by importing from a cheaper member country. This means specialization according to comparative advantage. Trade diversion means that original imports from world markets are replaced by imports from a more expensive member country. This phenomenon leads to a move from efficient producers, to less efficient producers, causing welfare losses.

companies (i.e. corporate integration) and economic integration of countries within regions (regional integration).

Table 2 outlines the factors that favor corporate and regional integration respectively. Some of these factors encourage either corporate integration or integration of countries, and others support both of them. Certainly, the operation of these factors does not necessarily speak in favour of either corporate or regional integration. It is not certain even when they are of significant weight.

The position of established multinational producers, or regions or countries may mean that neither corporate, regional nor national interests would be served by either participation in or promotion of regional groupings, especially in the absence of some form of compensation for the adjustment or displacement costs that might be entailed. For similar reasons it is not invariably in the interests of a particular multinational or country to promote regional integration if that would mean subjecting an established market to increased competition from new entrants (Dunning and Robson 1988).

In general, regional economic integration is nevertheless aiming at a more efficient and fluid functioning of markets than would be the case without this integration. Whereas corporate and economic integration on the company level is aiming at taking advantage of differences of markets by integrating company's functions, horizontally or vertically as the OLI-paradigm points out.

Table 2. Forces encouraging for corporate and regional integration

<i>Corporate Integration</i>	<i>Integration of Countries</i>
* Basic Motive: to improve profitability and the long-term competitive position	* Basic Motive: to increase efficiency or resource usage and to increase the economic and strategic (including political) strength of region and member countries
*To exploit economies of the firm	*To overcome structural market distortions e.g. tariff barriers, subsidies etc. and to encourage competition
*To reduce risk and uncertainty associated with market transactions	*To reduce imperfections in foreign exchange, capital and labor markets
*To protect quality control of intermediate and final products	*To facilitate the possibility of product and process specialization of firms within the region, and promote trade in intermediate products
*To capture the economies of synergy, which result from the common ownership of separate, but interrelated activities	*To facilitate the conduct of optimal policies and to secure gains from policy co-ordination in circumstances of structural and policy interdependence
*To protect the value of proprietary assets, e.g. technology, trademarks, management skills etc	*To develop economic and strategic strength by the adoption of a common policy towards non-member countries
To overcome the transaction costs of using markets.	To increase market size and improve the technological capability of member countries
To gain competitive strength	
To share common overheads	

Most of the findings of these newer integration studies suggest that more gains and benefits of economic integration can be expected from economic integration than the older customs union theory suggested. These benefits are increased FDI flows, lower transaction costs, development of new comparative advantages, gains of transfer of technology etc. Robson (1993) among others also argues that the benefits are greater than those related to trade creation and emphasized by traditional customs union theory.

What is encouraging and challenging for transition and developing economies as well as their companies is that newer integration theories imply that transnational regional

economic integration creates possibilities for them to exploit differences in factor endowments of subregions in order to promote external trade and foreign direct investment, i.e. existing complementarities as perceived by the private sector (Waldron 1997; Thant 1996).

This all means that special emphasis should be paid to the industrial, trade and technology policies of governments in this context. It is therefore utterly important to notice that the development of dynamic comparative advantages and location-specific advantages depends much on the possibilities for and number of cross-border transactions.

4. Economic policy challenges created by globalizing and integrating markets

As a consequence of globalization as well as economic integration development, the ability of economic and industrial policy to affect the actions of enterprises has changed. Countries and regions compete with location-specific advantages and economic policies try to contribute to the attractiveness of factors' locations. Policies have to try to increase that kind of comparative advantages that enterprises can use in their production to create their own competitive advantages. In this way the interaction of comparative advantage and competitive advantage defines the location of production.

For example, industrial and technological policy in Europe has experienced various periods of emphasis since the 1970s. Ylä-Anttila (1998) has divided them into three different periods:

1. Backing the losers (1970s)
2. Picking the winners (1980s)
3. Let the winner pick (1990s)

In the 1990s it is believed that policy which creates good preconditions for enterprises increases companies' abilities to create competitive advantages when these are at least partly believed to be connected to certain regions. Regions and national economies compete with each other over the attractiveness of their location and related matters. The ultimate aim is to entice internationally competitive companies.

A very important factor in companies' direct investment decisions is the possibilities to co-operate and network with other companies and organizations. Another important point is to strengthen the so called *private-public partnership*. The word public in this context refers to a kind of public (functional) environment which has influence on production and operation conditions of companies in certain area. Some of the most important sectors are communication and transportation connections, research and

development capacity, education and legislation and norms affecting a smooth co-operation between the private and public sectors. Evidently integration and globalization tendencies necessitate broader views on strategies, co-ordination and implementation of regional and industrial policies than we are used to.

The role of industrial policy certainly depends on a country's or region's phase of development. Porter (1990) has, in his analysis of competitiveness, characterised four different phases of economic development: (1) *factor-driven*; (2) *investment-driven*; (3) *innovation-driven*; and (4) *wealth-driven*. These phases cannot be separated too accurately. However, they describe the main components to which a country's economic and industrial competitive development at certain stages is based on. These phases also reflect the sources of advantage of a nation's enterprises in international competition and the nature and extent of internationally successful industries. These stages are shortly described below.

1) Practically all internationally successful industries draw their advantage from basic factors of production in the factor-driven stage. Only the factor conditions are seen as advantages while the technology and R&D development is low. There are only a few truly international companies. Domestic demand for exported goods may be modest and the economy is pretty sensitive to macroeconomic fluctuations and changes in exchange rates. In this phase the aim of a policy is to help the functioning of factor and product markets. Transfer of technology and attempts to increase investments are considered very important. The role of foreign companies is considerable, as they act as a channel for foreign markets and they bring foreign technology, knowledge and management with them to the host country.

2) In the investment-driven stage competitive advantage is based on nations' and companies' interests in investing heavily. Investments are mainly directed to process technology and modern production facilities etc. Competitive advantage is based on improved factor conditions as well as firm strategy, structure and rivalry. Home demand in this stage is still rather undeveloped, and related and supporting industries are not

functioning optimally. It is typical to this stage that wages and input prices are higher than before and employment is increasing. In the investment-driven stage the role of policy is to concentrate on long-term matters, and its credibility and stability is important for convincing investors to take actions. Public policy is obliged to support infrastructure projects and to develop general economic facilities.

3) In the innovation-driven stage a mix of industries operating successfully internationally increases and broadens. Companies create new technologies and methods. Companies also compete with low costs due to high productivity rather than low production factor costs. Home demand increases and become more sophisticated too as incomes rises, education level is higher etc. The growing industrial competitiveness leads also to more sophisticated industrial customers. Clusters emerge when related and supporting industries develop. The economy becomes stronger against outer shocks (like cost shocks and exchange rate movements) because of its ability to compete with technology and product differentiation. In the innovation-driven stage the primary aim of policy is to develop and sustain functional facilities for enterprises. This means well-functioning factors, product and financial markets. It also means corrections and improvements related to externalities, market imperfections and incentives.

4) Unlike other stages the wealth-driven phase is a stage of drift and ultimate decline. In this stage the economy is driven by past accumulation of wealth and becomes unable to generate new wealth. Enterprises become more vulnerable to uncompetitiveness. Firms take fewer risks and innovate less and at the same time investment rate decrease. Employees begin to lose motivation and so on. The result is that companies lose competitive advantage to foreign firms and may even start to move their headquarters from their original home country to another country. The standard of living and welfare is still rather high. The policy attempts in this stage try to increase the dynamism of the economy, innovations and profitability.

Countries or regions in different stage of development should recognize and understand their comparative advantage and hierarchical development phase compared to other

countries and regions. In this manner a country or region can develop its industry and economy so that it can fully take advantage of its comparative and location-specific advantages, and at the same time it is easier for companies to estimate their competitiveness against these factors. Other kinds of aspirations for example, to skip some phases of development (for example, moving from a factor-driven stage directly to the innovation-driven stage) is usually doomed to failure (Ozawa, 1996).

A particular stage of competitive development is connected to a certain pattern of export competitiveness. This means that the factor-driven stage is associated with factor-based trade advantages (i.e. primary and labour-intensive goods) and the investment driven-stage is tied to scale-based advantages (i.e. capital-intensive goods). The innovation-based stage is then again based on R&D-related advantages (i.e. high-technology products). Thus economic growth is accompanied by the changing patterns of dynamic comparative advantage.

Several researchers of international economics and international business like Dunning (1981) and Ozawa (1996) emphasize the dynamism of a region's comparative advantage, investment position as well as its companies' competitiveness. They also say that it develops as a region's economy (see table 3). This is due to changes in the level and structure of economy, development and changes in the amount of foreign direct investments. Furthermore, accumulation of capital and knowledge inevitably change the structure of a regions'/country's composition of factors of production, and thus also comparative advantage and location-specific advantages change. Ozawa also emphasizes the remarkable effect that foreign investments have on economic growth through an increase in trade.

In Ozawa's view, the pattern and directions of inflows and outflows of foreign capital change in conjunction with the stages of structural transformations in the economy. Inward FDI is typical for the first, factor-driven stage when seeking for cheap sources of raw materials and lower labour costs compared to home countries (see table 3). Transition from the factor-driven stage to investment-driven stage is related to an

outflow of investments from that economy to economies that have lower wage levels in labour-intensive industries and raw-material concentrated sectors. In this phase, a country concentrating in the production of capital-intensive products will attract foreign capital to sectors of heavy industry and chemicals as well as for construction of the development of economic infrastructure and the like. Most developing and transition countries are at the first stage, even though some of them are already at the second stage, where investments in capital-intensive activities start to play a central role.

Table 3. Stages of development, changing factor proportions and dynamic comparative advantage

<i>Stage of development</i>	<i>Factor-driven</i>	<i>Investment-driven</i>	<i>Innovation-driven</i>
Factor endowment proportions	Primary factors (natural resources and labour)	Physical capital	Human capital
Revealed comparative advantage of trade index (RCA) 1) unskilled labour intensive goods 2) technology intensive goods.	1) high 2) low	1) medium 2) medium	1) low 2) high
Inward DI	Factor-seeking	Market-seeking	Market/technology-seeking
Outward DI	Trade supportive resource-seeking	Low-cost labour-seeking	Market/technology-seeking surplus-recycling

Source: Adopted from Ozawa (1996)

So, the nation grows by upgrading its structure as its factor and technological endowment change with the accumulation of physical and human capital. Thus the

economy continuously evolves to develop new comparative advantage by shifting from technologically less sophisticated, low-productivity products to more sophisticated, higher-productivity industrial activities, i.e. with the possibility to position itself within higher value added chains in the world economy.

All in all, any developing or transition country which is about raising its standard of living should open its economy so as to avail itself of opportunities for trade interaction with and learning from more advanced countries. The literature confirms that an outward economic orientation and accelerated economic growth are highly correlated. Also, economic policy toward enterprises should encourage the improvement of their competitive capabilities and overall competitiveness. It is evident that the state itself does not create the factors for determining the success of competing enterprises, but can instead provide the conditions stimulating the development of such factors⁷. In the views of Dunning and Ozawa the main task of the government is to assure investment in the infrastructure in order to assist the formation of a dynamic comparative advantage.

⁷ The following policy actions are especially important in the context of a policy promoting development: stimulation of capital investment; stimulation of infrastructure investment; stimulation of innovations, research and development; support for education and training; spreading economic risks; promoting the development of information systems.

5. Conclusions

The liberalization of world trade and unification of foreign trade systems all over the world, as well as the increasing internationalization have necessitated increasing discussion concerning globalization. Economic globalization means that international businesses develop operating genuinely on a global level. The result is greater and deeper interdependence between countries that participate in world trade.

It has become crucial for countries and regions offering various facilities for production, business life and international companies to answer the challenges of globalization (positive or negative effects) and mobilization of factors of production across national borders. This is important since there is evidence to suggest that the forces determining the level of inward and outward direct investment and the balance between the two are linked to a country's competitiveness and stage of development.

The actions of multinational companies and the role of foreign direct investments have essential part in building and reconstructing the economy and different industries in host countries. This is especially true for economies which are seriously developing their industrial and economic structure, like many transition countries in Eastern Europe. The openness of markets and creation of possibilities for international business with the companies of more developed countries are thus one of the key questions for increasing welfare and industrial dynamism in transition and developing countries.

In general, the regional economic integration of countries is aiming at the more efficient and fluid functioning of markets than would be the case without economic integration. However, not only the form of integration (i.e. true or formal integration) procedure, but also the credibility of an integration arrangement has crucial influence on the success of the integration process and integration effects and dynamics.

Corporate and economic integration on the company level is aiming at taking advantage of differences of markets by integrating companies functions horizontally or vertically as the OLI-paradigm points out. The integration of markets enhances the need to rationalize production, management, organization and the whole value chain. This means that companies have to develop their competitive strategies and increase their efficiency; they also have to consider the new opportunities and risks of integrated markets.

Some remarks can also be made concerning economic and regional policy that takes into account globalization and integration tendencies. Firstly, governments should take actions to reduce the costs and risks of cross-border economic interaction. Secondly, governments could create integrated regional economic policies that are not independent of the industrialization and internationalization programs at their own national level. This could be arranged, for example, by creating initiatives to establish contiguous transnational sub-regions characterized by significant differences in factor endowments. These regions could then exploit the principle of comparative advantage to attract foreign direct investment committed to the production of exports. Thirdly, progress in answering the challenges of globalization and integration needs political consensus and co-operation as well as a special emphasis on promoting company level integration.

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