Inward investment policy in the European Community in the 1990s

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The objective of this article is to provide an overview of issues pertaining to inward foreign-direct-investment policy in the European Community in the 1990s, and to provide guidelines for policy formulation with particular reference to policy at the microeconomic level.

Transnational corporations have an important role to play both in advancing and in retarding progress towards economic and monetary union. In particular, their potential centripetal effects and the dislocative consequences of corporate restructuring represent major problem areas. There is no agreed approach and general policy to transnational corporations, encouraging beggar-thy-neighbour policies through a wide range of national measures. Accepting the disadvantages of a partial framework, suggestions for an integrated and coordinated approach to inward investment policy are presented, mainly developing from policies in existence at present.

This is a critical period for policy debate and formulation for three reasons.

First, the European Community (EC) is entering a new phase in its evolution with the implementation of the Single Market measures and with the initial steps being taken towards economic and monetary union. Second, the response of transnational corporations (TNCs) to, and their impact on, economic integration and the questionable long-term impact of TNCs on host EC economies, especially in the periphery, requires attention. Third, the environment for attracting new greenfield manufacturing facilities (especially) is proving to be much more difficult than formerly, and restructuring will be a characteristic of many established TNCs; both factors encourage intense competitive bidding between countries for investment.

The policy context

The European Community was formed under the terms of the Treaty of Rome on 1 January 1958. During the first stages of the evolution of the EC from 1958 to

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1969, the six founder members—France, the Federal Republic of Germany, Italy, the Netherlands, Belgium and Luxembourg—eliminated internal tariffs and quotas on intra-EC trade in goods and a common external tariff was established, and some preliminary steps were taken to deal with non-tariff barriers. The Community was enlarged in 1973 when the United Kingdom, Ireland and Denmark joined, to be followed in 1981 by Greece and in 1986 by Spain and Portugal. During all of this period, a variety of institutional and policy developments took place, but progress was hesitant and often misdirected; the EC remained fundamentally a *customs union* rather than the *common market* envisaged in the Rome Treaty (Swann, 1992).

To gain new impetus for European unification, the Single Market programme was launched in the mid-1980s to secure free trade in goods, services, labour and capital through the removal of non-tariff barriers. The target date for completion of the Single Market, involving 293 legislative measures, was 31 December 1992. The vast majority of measures was passed by this date, although some were weaker than envisaged and others will not come into effect until later, while key issues relating to fiscal harmonization remain to be negotiated. Compliance, in any event, and the ending of conscious or unconscious national discrimination, will take much longer to achieve. Nevertheless, in terms of Bela Balassa's (1961) stages of integration a new milestone on the road to *economic and monetary union* was achieved.

Economic and monetary union was linked to the completion of the Single Market (the common market stage), but also required cooperation on research and technology, the environment, social policy and, particularly, economic and social cohesion. The Delors Committee (1989) envisaged a three-stage plan, with a transition to permanently fixed exchange rates and then to a single European currency, issued through a European central banking system with responsibility for EC monetary and exchange rate policies. By the terms of the Treaty on European Union (hereafter "Maastricht Treaty") of 7 February 1992 (Commission of the European Communities, 1992), the date for the creation of European economic and monetary union with a single currency would be 1 January 1999. As events during 1992 and 1993 showed, this timetable is totally unrealistic for all 12 members as a bloc, but the initiative will generate further hesitant progress towards the ultimate goal.

In completing this overview of the EC's evolution, it is important to record the establishment of the European Economic Area agreement which links the EC to the rest of Western Europe (except Switzerland), with Austria, Finland, Norway and Sweden to become members on 1 January 1995. Even more significantly, the long-run intention is that the countries of Central and Eastern Europe will become members of the EC.

There have been numerous studies of the economic effects of increasing European integration. Taking an historical overview, L. Alan Winters (1993) suggested that, on the basis of available evidence, it would be difficult to conclude that the EC had significantly improved macroeconomic performance. Considering the Single Market programme *ex-ante,* the first calculations emerging from the Cecchini Report (Cecchini *et al.*, 1988; see also Emerson *et al.*, 1988) suggested gains of around 5 per cent of gross domestic product (GDP) over the medium term; these were mainly linked to the removal or reduction of non-tariff barriers, such as protective public procurement, divergent standards and regulatory diversity. Further, less qualifiable and longer-term dynamic effects, primarily related to faster rates of innovation, were envisaged. The studies undertaken since 1988 have been less optimistic about the likely outcomes (Winters, 1992), suggesting that Single Market effects would be impossible to distinguish from other influences on economic growth at least in the early years (Mayes *et al.*, 1992; Mayes, 1993). Fundamental problems of European competitiveness have been a source of concern for many authors (Hughes, 1993).

The most important issue for this article concerns the distribution effects of integration among EC member states and associated adjustment costs. Willem Molle (1990) showed that regional disparities in GDP per head declined between 1950 and the mid-1980s, although he noted that no formal proof of any equalizing effect of EC integration had as yet been provided. The ranking of European regions by their level of prosperity remained very stable, with two exceptions: first, all German regions moved strongly upwards; second, all regions of the United Kingdom and Belgium fell back. Divergences are still very substantial, with three member states—Greece, Portugal and Ireland—having a per capita GDP below 75 per cent of the EC average; the unemployment rate in some areas is five times higher than in others.

For the future, the balance of centrifugal *vs* centripetal effects is of crucial importance, since convergence is necessary if the goals of the Maastricht Treaty on economic and monetary union are to be achieved. It has been argued (Nam and Reuter, 1991) that the less favoured regions, mainly in the European periphery, may lose out from the process of integration, and Christine Oughton (1993) indicated that Greece and Portugal, in particular, face a significant possibility of being left behind (see also Shepley and Wilmot, 1992). The situation is complicated by the creation of the European Economic Area (some of the countries of which are peripheral yet have above average income levels) and by unknown Central and Eastern European effects. The fact remains that large-scale migration of labour is not a realistic possibility for producing convergence—which leaves capital flows, either private or official (Panic, 1992). The European Community structural funds,[1] which provide aid to its disadvantaged regions, have been increased over the years with further large rises planned; but generally they are tiny in relation to the scale of the problem. Clearly, therefore, private investment, particularly that by TNCs, has potentially a major role to play in encouraging convergence and thus the evolution to economic and monetary union.

Transnational corporations in the European Community

There is an extensive literature on the themes of and interaction between corporate integration and regional integration (see Dunning and Robson, 1988; Robson, 1993; and United Nations, Transnational Corporations and Management Division, 1993 for reviews focusing on TNCs and the EC). On the one hand, in regard to the goals of European integration, corporate activities should produce a more efficient allocation of resources and thus foster the attainment of integration, unless union-wide monopolies or oligopolies replace their national counterparts and lead to a concentration of economic power and anti-competitive behaviour. On the other hand, in so far as economic integration helps lower production costs and cross-border transport costs or raises levels of consumer demand (as with the Single Market programme), intra-regional product and process specialization will be encouraged; this process may facilitate additional economies of scale and enable multi-product firms to exploit further economies of scope. Where the production or transactional efficiency of firms located in the integrated region is improved, this may also assist the competitiveness of these enterprises in world markets.

A requirement for the attainment of these potential benefits is, of course, corporate restructuring with associated distribution costs, and with no certainty that the gains will be shared evenly among countries and regions. The literature on TNCs in the EC has dealt with a wide range of issues, which were well summarized by John H. Dunning (1993). The evolution of the EC from 1958 to the mid-1980s positively influenced the volume of new inward foreign direct investment (FDI) (UN, TCMD, 1993) and caused a restructuring of existing investments (especially perhaps following the 1973 enlargement with the entry of the United Kingdom into the Community—Young, Hood

[1] A variety of programmes are operated with the objectives of providing investment and productivity growth in less developed regions; reviving areas hard hit by adjustment, e.g., coal, shipbuilding regions; combating long-term unemployment and integrating young people into the labour market; the adjustment of agriculture and the development of rural areas. See Christopher Bliss (1990) who warned of the dangers of compounding the problems of disadvantaged regions by encouraging the growth of rent-seeking grant economies. Ash Amin and Anders Malmberg (1992) noted that, even with the proposed doubling of real expenditure on the structural funds, they would still amount to only 3 per cent of the Community's GDP.

and Hamill, 1988; for early evidence on European TNCs, see Franko, 1977). The run-up to the Single Market saw a large surge in Japanese direct investment and the entry of a number of companies from Taiwan Province of China and the Republic of Korea, all linked to anti-dumping measures (Yoshitomi/Sumitomo Life Research Institute, 1991; Bürgenmeier and Muchielli, 1991; Hood and Truijens, 1993). Aside from greenfield investments, entry and expansion through mergers, acquisitions and alliances increased considerably, especially in mature and service industries and involving non-EC European and EC companies (Young and Hamill, 1992). Overall, the EC has attracted an increased share of inward direct investment from all countries since its formation (UN,TCMD, 1993).

Despite the above, it is arguable that the major effects of the Single Market through the 1990s will relate to restructuring activity by "insider" firms (TNCs with existing investments in the Community). In industries that follow import-substituting (multi-domestic) strategies within Europe and among TNC affiliates that serve markets on a national basis, the removal of non-tariff barriers will encourage TNCs to exploit asset advantages that optimize at the European level, for example, by enhancing the opportunities to develop and utilize asset advantages that are scale or learning sensitive. Furthermore, there will also be enhanced opportunities to leverage locational advantage by siting full manufacturing or component production according to country-specific attributes within Europe. So both centralization of production and/or decentralization of products/processes according to comparative advantage will be in evidence within the Single Market (Young, McDermott and Dunlop, 1991). Patterns will vary and include more intensive product (i.e., horizontal) specialization, with TNCs' European plants specializing on particular product lines for European or world markets; vertical specialization along the value added chain at different locations across Europe; and *inter*-firm specialization and rationalization (Dunning, 1993). On the basis of the evidence available to date, the major gainers from EC integration have been non-EC TNCs; although Dunning (1993, pp. 493-494) suggests that the "Single Market will be particularly beneficial to European-owned firms in services and in manufacturing sectors where the benefits of customization are especially important". UNCTC (1990) and UN,TCMD (1993, especially chapters 4 and 5) provide details of strategic changes which have occurred, giving illustrations of individual TNCs and nationality of ownership effects (see also Robson, 1993).

A key policy point for this article is that very large-scale restructuring and rationalization will be in evidence, affecting member states through job losses or job gains and higher or lower value added operations, and leading in turn to intense inter-country competitive bidding for available internationally mobile investment. The issue of the regional impact of TNC investment is a long-standing one, with fears that transnational activity would concentrate in the central core of the Community to the detriment of peripheral areas (Clark, Wilson and Bradley, 1969; Dunning, 1972). Since the establishment of the EC, in fact, inward direct investment has oriented strongly towards the United Kingdom (both central and peripheral regions), and other countries on the periphery, such as Spain and Ireland have also been major recipients of investment, in part due to the payment of regional incentives (P.A. Cambridge Economic Consultants, 1989). Nevertheless there are still questions relating to the nature and contribution of this transnational investment which need to be answered: corporate location consultants analysing business opportunities in Europe produce separate listings of suitable areas for research and development centres (in which German and French locations are prominent), European regional headquarters (locations close to Europe's main commercial centres), greenfield manufacturing plants (many peripheral areas including Greece, Portugal, Spain, Ireland and northern United Kingdom), distribution and service centres (regions at the centre of the European Economic Area) and so on (Ernst & Young, 1992; Netherlands Economic Institute, 1992); regions with greatest market access are located in the so-called "hot banana" which extends from south-east United Kingdom, through the Benelux countries, the Rhine and Ruhr, to Switzerland and northern Italy (*Financial Times*, 21 October 1992). To the extent that TNCs respond to such locational advice, a tendency would exist for higher value-added and decision-making activities to be located closer to the market centre. A number of the chapters in Peter Robson (1993) present relevant evidence on this issue.

There have been a large number of studies on the contribution of inward investment to host countries and regions within the EC. Empirical evidence from the United Kingdom regions alone (Young, Hood and Peters, 1993 on Scotland; Northern Ireland Economic Development Council, 1992 on Northern Ireland; Hill and Munday, 1991 on Wales; and English Unit, 1991 on the English regions) indicates that there have been significant static gains from (mainly) production plants, but few dynamic benefits. The former relate to structural upgrading resulting from the inflow of investment into industries like electronics, while the performance of foreign companies on indicators such as net output, capital expenditure and wages and salaries has been better than that of indigenous firms; inward investment has also improved the export orientation of regional economies. By contrast, the rate of closure and divestment in regional economies like Scotland (Young, Hood and Peters, 1993) has been high, requiring a continuing high rate of new inward investment to sustain the stock. Even more important is the fact that spin-off and demonstration effects have been low; there were few illustrations of integrated entrepreneurial multinational activity and no complete value-added chain of TNC operations that might begin to produce dynamic comparative advantage. The follow-on conclusion is that, at least for mature industrial regions like those of the United Kingdom, TNC investment has not enabled the areas to break free from their peripherality. (What would have happened in the absence of FDI and whether this could have achieved such a goal also needs to be considered, of course.) The same general conclusions apply to other countries in the periphery, such as Ireland, although the Netherlands Economic Institute (1992, p.14) observed a more positive association between inward investment and development when "active and consistent policies" have been pursued by regional governments.

Policy reality

The difficulties and dilemmas that emanate from the imbalance in the sphere of operations between global TNCs and the national Governments are well recognized. Simply because of the globalization of economic activity, there are strong arguments on grounds of both efficiency and equity for a global approach to policy. Without this, TNCs have the opportunity both to circumvent national policies and to play Governments off against one another. John M. Kline (1993) most recently lamented the absence of a comprehensive agreement on FDI issues, as the third leg in the international economic order constructed around the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) and the World Bank group after the Second World War.

Despite reduced intervention and greater liberalization at the national level in the past 10-15 years, the present situation is that a maze of partial, mandatory and voluntary mechanisms produce a "confusing regulatory kaleidoscope" (Kline, 1993, p.153). It is not simply FDI policies *per se* that impact on the TNC; a wide range of Government macroeconomic policies increases and/or decreases market imperfections and can increase and/or decrease FDI flows (Brewer, 1993). Recognizing the fact that TNCs impinge on all aspects of economic life, Dunning (1992) argued the case for a strategic, coordinated approach to domestic macro-organizational policies. The objectives are twofold: first, to promote competitiveness and reduce market failure; and, second, to attempt to reach an international accord on a level playing field. There is undoubtedly a need at the national level to integrate investment, technology and trade policies with fiscal and monetary policies (Vonortâs, 1990). The real problem is whether national coordination will facilitate moves towards an international accord as opposed to maintaining or exacerbating beggar-thy-neighbour efforts. Certainly there is still a need for the third leg in managing world trade, finance and FDI issues.

Accepting the need for a comprehensive policy framework and the dangers of creating further imperfections from partial measures, the focus of this article is the narrower one of inward FDI policy in the EC. If and when the European Community achieves economic and monetary union, a comprehensive framework would be in place or would be rendered unnecessary. As suggested in the first section, however, a failure to consider TNC activities in the run-up to economic and monetary union could actually impede or halt progress towards the latter.

Considering the European Community level of policy, it is necessary to distinguish between the EC as a union and as a series of nation states. At its current state of evolution, the EC exhibits both characteristics. From the first perspective, the EC could be seen as a microcosm of the world economy: internally, supranational policies could be devised to remedy market imperfections, e.g., EC anti-trust policy to ensure that such characteristics of TNCs as large size and global reach do not lead to the concentration and misuse of economic power; externally, the bargaining power of the bloc could be utilized to extract favourable terms from TNCs wishing to operate within the bloc, subject to commitments to international treaties and absence of retaliation from other countries. However, the attraction of inward investment (as well as the support of indigenous industry) also requires an attractive investment climate, meaning the provision of an adequate education, transport and telecommunications infrastructure, and of legislation influencing human and physical capital formation and technological development, the promotion of an efficient market system and a stable macro-economic environment. Even then such policies might only ensure static gains from inward investment, as opposed to supporting dynamic comparative advantage.

Given the wide range of measures involved, the potential for conflict between supranational authority and national sovereignty clearly arises. It is argued in the literature (Winters, 1988; Safarian, 1991) that reduced border measures in the Single Market would encourage increased national subsidies, included within which would be incentives to attract inward investment especially from outside the EC. The outcome could be counterproductive competitive bidding between locations unless incentives were controlled. This would be more likely if the perceived role of FDI in economic development was markedly different between countries, and if the members themselves were at significantly different levels of economic development. In the latter case, there could well be a tendency for lower income bloc members to emphasize TNC-led or -supported development strategies following the model of Japan and the Asian newly industrialized countries (Ozawa, 1992); the policy stance would involve heavy expenditures on investment promotion and a highly liberal operating regime. In the more developed countries, the attraction of FDI would likely be balanced against a desire to support indigenous industry and national champions. This conclusion from analysis at the industry level is supported by macro-economic perspectives in which inequalities between countries and regions, especially within a framework of fixed exchange rates and in recession conditions, encourage economic nationalism (Panic, 1991).[2] A. Edward Safarian (1991, p.199) argued that: "It is going to be difficult, if not impossible, for the EC to develop the kind of coordination needed in these and other areas to assure net economic gain for the Community from strategic trade and investment policy".

Inward investment policy in the European Community

In a 1973 document, "Multinational undertakings and the Community" (reproduced in Robinson, 1983, p.233), the Commission stated that: "measures to be undertaken should not impede the development of a phenomenon with recognised economic and social advantages but . . . merely aim at guarding the Community against its harmful effects with the help of a suitable legal framework . . ." containing "no discriminatory aspect".

The three principles of treatment were thus a legal framework, as opposed to voluntary codes of conduct; a comprehensive framework, implying a rejection of specific isolated measures; and non-discriminatory treatment between indigenous and domestic firms. Means by which such (vague) objectives were to be achieved included the harmonization of company law, the harmonization of corporate tax systems, the harmonization of national and regional aids, worker protection, increased provision of information on the activities of TNCs, and competition policy. The TNC programme was in fact soon withdrawn (Robson, 1993); and in the discussions and implementation of the Single Market, virtually no reference was made to TNCs, the assumption apparently being that international production and trade were undertaken by uni-national firms (Cecchini *et al.*, 1988; Emerson *et al.*, 1988; and see the criticisms of Panic, 1991). The fact is that there is an agreed approach to TNCs and a general policy (Thomsen and Nicolaides, 1991). What exists is a patchwork of uncoordinated measures at the EC level, exacerbated by fragmentation at the national level. The principle of maintaining a competitive market for EC and non-EC enterprises is strongly upheld, but in exchange "reciprocity" is expected. This means that countries outside the Community should not close their borders to EC companies, and should not allow their domestic enterprises to engage in unfair practices to exploit the Community market (Belaud *et al.*, 1993).

The requirement for a Community industrial policy is now recognized (Commission of the European Communities, 1991a), and the Maastricht Treaty provides for action at EC level in the domain of industrial policy. However, as yet, little progress has been made on the content of industrial policy except in the areas of research and

[2] The refusal of the United Kingdom to agree to the Protocol on Social Policy annexed to the Maastricht Treaty (which *inter alia* establishes work standards, a minimum wage and industrial relations procedures) may be regarded as evidence of this.

development, as well as technology (Holmes, 1993; Catinat, 1993); and while there is a recognition of the globalization of markets, comment on TNCs is restricted to advocating increased European TNC investment in Eastern Europe and the Far East, accepting that this must be matched by "parallel market opening" (Commission of the European Communities, 1991, p.21).

Considering the individual components of policy that are relevant to FDI, *competition policy* in the EC faces the classic anti-trust dilemma, desiring on the one hand to prevent harmful concentration, and on the other to encourage coordination and rationalization to increase the competitiveness of European industry (Bachtler and Raines, 1992). There is recognition too that the definition of the "relevant market" for assessing the impact of agreements, mergers, etc. might need to be a global rather than a purely EC market (Belaud *et al.*, 1993). It is for such reasons that Community competition policy has appeared to be fairly liberal.

Developments in competition policy historically have revolved around the implementation of Articles 85 and 86 of the founding Treaty of Rome. The aim of Article 85 is to regulate anti-competitive cooperation or restrictive agreements between any two or more businesses, while Article 86 prohibits abuse of a dominant position. Mergers and acquisitions not occupying a monopoly position were not covered by these Articles, a big omission in the context of the Single Market where restructuring "has given rise and will continue to give rise to a wave of mergers . . ." (Commission of the European Communities, 1990), which are not adequately covered by national rules since these are restricted to the respective territories of the member states concerned. In response to this omission, the so-called Merger Control Regulation relating to Community-scale mergers was introduced on 21 September 1990 (OECD, 1992; Hamill and Castledine, 1992). Three criteria are used in defining Community-scale mergers: first, a threshold of at least ECU (European Currency Unit) 5 billion ($6 billion, approximately) for the world-wide sales of all the businesses concerned; second, a threshold of at least ECU 250 million ($300 million) for Community-wide turnover of at least two of the businesses concerned; third, Community control does not apply if each of the businesses concerned achieves two thirds of its turnover within one and the same member state (hence mergers whose impact is primarily national are excluded). The legislation covers cross-border mergers within the EC, EC acquisitions by non-EC firms, and, controversially, because of the extraterritorial implications, mergers by non-EC firms (on the latter see Ryba Jr., 1992).

The Regulation (Council Regulation (EEC) No. 4064/89 of 21 December 1989) indicated that broad criteria of competitive and non-competitive factors including management, labour and social-cohesion variables would be considered, but in the first year of operation at least, when 52 mergers were approved and only one blocked (the acquisition of deHavilland Aircraft of Canada by ATR, a joint venture of Aerospatiale of France and Alenia of Italy), the emphasis was primarily on market efficiency considerations. A criticism of the Regulation was that it excluded oligopolies, that is, highly concentrated markets where there was no market leader, but in 1992 action was taken against a joint dominant position in the Nestlé/Perrier case (Belaud *et al.*, 1993). It is not certain, however, whether joint ventures are adequately handled either by Article 85 or by the Merger Control Regulation. Discussions have been taking place on lowering the thresholds for EC involvement, with the Commission seeking an overall threshold of ECU 2 billion and a Community threshold of ECU 100 million: companies and industry associations are reported to be in favour of this approach, but the national authorities in some countries are opposed. Nevertheless, the Merger Control Regulation is an important step forward and represents a substantial strengthening of competition policy. As for Articles 85 and 86, these do contain significant teeth, but a problem is the slow pace of decision-making: on 31 December 1989, for example, there were 3,239 cases pending.

A second area of EC policy that impinges significantly on TNCs is that of *regional policy*. Mention has been made previously of direct Community efforts to ameliorate regional disparities by the use of the structural funds (including the European Regional Development Fund which since 1975 has stimulated investment in economic activities and assisted infrastructural development, and the European Social Fund which is mainly concerned with worker retraining). The Commission is also involved indirectly by setting ceilings on the regional incentives that can be offered by member States in an attempt to limit competitive bidding for FDI. Rules were introduced first in 1971 and elaborated in 1975, 1979 and 1988 (Lodge, 1989; Swann, 1992). They specify the most generous aid ceilings for regions which, by comparison with the Community average, suffer from high unemployment or low living standards, i.e. the Republic of Ireland, Northern Ireland (United Kingdom), parts of the Mezzogiorno (Italy), Greece, Portugal, and some areas in Spain, where the net grant equivalent aid intensity ceiling is 75 per cent of initial investment (updated from Bachtler, Clement and Yuill, 1989). Simply because the countries are poor, however, they may not be able to offer aid at the maximum level permitted, and the 75 per cent ceiling is essentially academic. The Commission's aims over time have been to improve the transparency of national schemes and reduce both the automaticity of aid schemes and the designated regions qualifying for assistance. In regard to transparency, capital grants have been viewed as the most appropriate form of investment incentive. These have played a more and more dominant role within regional incentive packages, although greater selectivity has been incorporated into the award decision-making process in some northern European countries, with benefits being sought for the regional or national economy in terms of job creation, local purchasing or exports (Bachtler, 1990).

Because of national rules and circumstances, not all countries offer the maximum aid permitted under EC rules, and capital grant offers to individual companies may be lower still. Nevertheless, other incentives may be available in the form of labour-related subsidies and infrastructure improvements, and these make the true position much more opaque. Monitoring and enforcement arrangements, moreover, vary between countries. In reality, it is doubtful, therefore, if the intensity of competitive bidding has reduced over time despite the Commission's efforts. This is a critical issue as the pace of corporate cross-border rationalization intensifies during the 1990s (in the early months of 1993 alone, large-scale rationalization and production switching by TNCs such as Hoover, Nestlé, Leyland Daf and Digital were very much in the news in Europe). The influence of regional incentives on locational decision-making has been much researched, indicating a minor influence overall but a possibly significant "tipping effect" at the margin. It is knowledge of the latter which can lead to fierce, no-holds barred competition between (and indeed within) nation states both for new, greenfield investments and reorganizations.

Before leaving the topic of regional policy, it is worth noting that competition and regional policies may on occasion be at odds with each other as, for example, where investment incentives below the maximum allowable for the region are offered, but the effect is still to produce over-capacity (see Belaud *et al.*, 1993 on the dispute involving aid packages to Fiat-Volkswagen in Portugal). This issue is to be tackled from 1 January 1994 when the domain for consideration of State aid becomes the Community level, i.e., aid that provides regional development in a *Community* as opposed to a *national* context will be approved.

It is not feasible in this article to discuss the many other aspects of Community policy that impact upon TNCs, as upon all Community enterprises operating across borders.[3] However, comment is necessary on one of the few measures

[3] For instance, not all aspects of state aids to industry have been reviewed. Special state-aid rules apply to steel, shipbuilding, synthetic fibres, cars, farming, factories, transport and coal, subject to the principle of avoiding over-capacity. The topic of technology policy is also important (Goodman, 1993), where there are potential problems concerning the involvement of non-EC enterprises in EC research and development programmes. The 1992 budget for the latter represented about 5 per cent of civil public research and development spending in the Community. To comply with GATT rules, Community funding of individual projects does not usually exceed 50 per cent. Deregulation is a further issue where the TNC dimension will be of major significance. National barriers in air transport are to be abolished by the end of 1996. In telecommunications, only a small portion of the sector has been exposed to competition thus far, and progress has been slow and limited in electricity and gas supply and in postal services.

specifically directed at non-EC enterprises (particularly Japan and the Asian newly industrializing countries) which is in the area of *industrial policy*. Voluntary export restraints were negotiated for cars, fork-lift trucks, colour televisions, video-cassette recorders, motor cycles, watches, machine tools etc. with Japan, and for some of these same products (plus footwear, radios, cutlery and ceramics) with Taiwan Province of China, the Republic of Korea and Brazil. These were nationally negotiated either by Governments or industries, albeit within an EC umbrella. In the case of cars, for instance, national voluntary export restraints are being replaced from 1993 by a form of Community-wide voluntary export restraints and monitoring of both imports and so-called transplant production. Such voluntary export restraints, backed up by anti-dumping duties (of which 120 were in force at the beginning of 1990; see Schreyer, 1991), had an important influence on the establishment of Japanese assembly factories in the EC (Hood and Truijens, 1993). Since these assembly plants could be using dumped parts, Regulation 2423/88 extended the anti-dumping legislation to apply to this trade also, backed up by the imposition of local content rules. These measures introduce discrimination into a policy that has been largely non-discriminatory, although it is arguable that the FDI constituents are incidental to trade policy which is chiefly bilateral and therefore discriminatory. What is also true is that trade-related investment measures (TRIMS) and investment-related trade measures (IRTMs) (see UN,TCMD, 1992) have had more direct influence on Japanese FDI than any other: competition and social policies in the EC set a framework which is little different to that elsewhere among OECD countries, and regional policy has an impact at the intra-EC level.

There continues to be an extensive debate on this subject (a good review of the arguments is in Micossi and Viesti, 1991; see also Curzon and Curzon, 1987; Hindley, 1988; Digby, Smith and Venables, 1988). Some of the strongest views in favour of Japanese FDI in the EC have been put forward by Walter Eltis and Douglas Fraser (1992, p.19) viz.: "If [EC] companies are already as efficient as the best in the world, they have nothing to fear from Japanese competition. If they are not, then they should hasten to get the best performers . . . into their countries to demonstrate what needs to be done at first hand". What needs to be questioned is whether there is a fair balance in the benefits obtained from TNCs in comparison with the gains the companies may make, especially in the Single Market, and whether reciprocity exists. It is recognized that this presents great policy challenges, given widely different attitudes among national governments internally in the Community, and the game of threat, deceit and bluff externally.

Inward investment policy at the national level

The above discussion on policy at the Community level reveals a wide scope for influencing TNCs at the margin through national policies (and to allow companies to play off one nation state against another). The principle of "subsidiarity", inscribed in general terms in the Maastricht Treaty, has now established that the Community only handles activities which it is able to deal with more effectively than member states acting alone.[4]

In regard to TNCs *per se*, differences in policy attitudes between national Governments are in part a reflection of different economic circumstances as well as general philosophy: in the Republic of Ireland attracting TNCs, through aggressive promotional policies, was perceived as the route to industrialization; in Portugal and Spain the regulated attraction of TNCs, through joint venture rules, performance requirements etc., was one arm of the countries' industrialization policies in the years prior to their entry into the EC; and in France, until the early 1980s, attitudes and policies towards TNCs fluctuated from the welcoming to the hostile, while more recently attitudes to Japanese investment have sometimes been obstructionist and protectionist.

The United Kingdom (and, more quietly, Germany) have been most liberal, in the former case a reflection of the country's own outward FDI stake as well as a belief in the economic benefits from inward FDI, and *laissez-faire* policies of Governments since 1979. Constraints at the EC level and the economic problems of the 1980s and 1990s have tended to bring about greater uniformity in attitudes and approaches, with an emphasis on obtaining a share of the non-EC investment flowing into the Community.

In such industries as autos, where there are national champions, however, there has been resentment at the British encouragement of Japanese inward FDI in car manufacturing. Unsuccessful attempts were made by France, for example,to prevent Japanese exports from the United Kingdom to the rest of the EC (Julius and Thomsen, 1988). Although there are differences in terms of countries and industries targeted, the common element in promotional activity has been intense competition involving EC nations, regions and cities, backed up where necessary by a wide variety of incentives (as noted above, EC rules still permit a good deal of discretion at national and local levels). It has been argued (Safarian, 1991) that FDI policies are tending to converge to domestic industrial policies. This may be so in general, but it is still possible to identify, implicitly or explicitly, a "TNC factor" in policy.

[4] Expressed more formally by Dominique Bureau and Paul Champsaur (1992, p.89), this means that "budgetary intervention at the Community level ought to be admitted only in the presence of cross-border externalities or economies of scale, which cannot be properly alleviated by a simple coordination between concerned national Governments".

Indeed, it may be argued that in a country like the United Kingdom during the 1980s and early 1990s, the only industrial policy was a TNC attraction policy.

When considering the factors influencing inward FDI—proximity to markets, quality and availability of labour, transport and telecommunications infrastructure, language and cultural affinity, financial variables (especially corporate location and financial incentives) and effective promotion (as with financial incentives, especially important in influencing the final choice of location) (Netherlands Economic Institute, 1992)—it is apparent that there is a good deal of discretion at the national level. Corporate tax rates vary significantly, from the Republic of Ireland's 10 per cent rate on financial and manufacturing services profits available until 2010 and the United Kingdom's low corporation tax rate of 33 per cent, to Germany where the total level of company taxation is double that in the United Kingdom (Bachtler, Clement and Yuill, 1989; see also Mintz and Tsiopoulos, 1992). Differences in financial incentives have been noted, and the resources devoted to promotional policies also vary considerably. In relation to the latter, all countries and many regions within countries have inward investment promotional agencies that are responsible for information activities; planning and targeting; promotion through advertising, investment seminars, overseas missions, direct mail and telemarketing campaigns; negotiation, including the presentation of specific financial and allied packages; settlement, expediting the processing of applications and permits, and coordinating relevant bodies to minimize blockages as the project is set up; and the provision of post-investment services ("after care") (Wells and Wint, 1990; see also Young, Hood and Hamill, 1988 for a review of the United Kingdom situation). These are legitimate and useful activities, even if the plethora of intra-country agencies may sometimes operate against the interests of the country as a whole.

In the context of this article, especial interest attaches to the after-care function of inward investment agencies in Europe, which is becoming increasingly important as countries try to anchor existing investments to locations, forestall rationalizations and secure expansionary projects as growing TNCs build their operations in Europe. "Service to the customer" covers a wide range of both operational and strategic activities, ranging from schooling for the children of TNC executives, worker training and assistance with customs or value-added tax problems to eliciting ministerial support in making the case for new investment by parent corporations or the prevention of closure. The argument to be presented here is that, at the strategic level, at least, much more support is needed from Community policy.

In the recent past, the most problematic isssue in relations between member states (and one that also impinges on the attraction of TNCs) has concerned so-called monetary, fiscal and social dumping, with the United Kingdom, once again, being condemned for attempting to undermine the EC consensus. In the area of social policy, the United Kingdom has obtained an "opt-out" from the Protocol on Social Policy which is contained as an annex to the Maastricht Treaty. This Community Charter of Basic Social Rights for Workers seeks to ensure that the search for efficiency and competitiveness will be parallelled by similar advances in the social field, and includes worker rights to fair remuneration, social protection, training and information, consultation and participation. There is no question that economic nationalism added to basic philosophical differences between countries, whether relating to wage levels, the ability to close factories and make workers redundant[5] or any other issue, could seriously undermine the EC's evolution. TNCs, in turn, are uniquely placed to exploit these national differences and therefore exacerbate national tensions. The challenge is to strike a balance that constrains large-scale, dislocative corporate restructuring without at the same time placing excessive limits on flexibility which would damage competitiveness.

Strategic inward investment policy in the European Community

Strategic FDI policy has been defined by the United Nations (UN,TCMD, 1992, p. 272) as policy designed to "increase the long-run benefits of FDI to an economy, both economic and non-economic, even if such a policy were to impose some short-run cost (for example by reducing FDI inflows or causing a fiscal drain)". Such a policy thus has as its objectives the realization of long-term benefits and the transfer of rents from foreign companies. This article focuses on only one component of this, namely, inward FDI. The case for a Community-wide approach seems to be very strong here.

- First, the EC is an institution and economic region like no other: the Single Market offers large and growing (as integration proceeds) opportunities for companies, with TNCs the major gainers as they operate unencumbered by national loyalties and preconceived notions of borders. The EC and its nation states benefit from the transnational presence to be sure, but they must also bear the cost burden which primarily emanates from TNCs restructuring across borders. Since its inception in 1958, the EC has been in a constant state of evolution and this will continue through the 1990s and beyond, with intermittent progress towards

[5] A good illustration of policy differences emerges in the field of worker protection. In Denmark, Ireland and the United Kingdom, worker rights are very limited and even large-scale redundancies face few constraints. In Portugal, Spain, Greece and Italy, by comparison, plant closures and redundancies can only be undertaken within the framework of wide-ranging labour laws. See *Financial Times*, 15 February 1993.

economic and monetary union and doubtless a number of enlargements. Transnational corporations have responded through alignments to the locations and roles of their facilities in the EC (as well as responses induced by competition, technological change, shortening product-life cycles and so on), causing large dislocation and restructuring costs on occasions to nation states. The conventional solution recommended is for public investment in worker retraining and in the physical infrastructure; but in the light of the comments above it does seem that the burden should be shared more equitably between firms and Governments. Alongside this thrust of argument is the fact that large firms have been the major beneficiaries of EC research and development programmes, of regional incentive schemes (given their bargaining position) and of the relaxed stance of competition policy (Amin and Malmberg, 1992; Bachtler and Raines, 1992).

- A second and related reason for a Community inward FDI policy concerns the need to promote balanced economic development across the EC. Supporting the views expressed here, the EC Commission recognizes that increased integration may exacerbate regional disparities. This means that policy measures should at least be supportive of more integrated transnational and ancillary industry development at the national/regional level. For a TNC operating in a single European market, the location of different value-adding activities and sourcing policies is determined by economic logic which may create unbalanced development and hinder the process of economic integration (and which, therefore, may not be in companies' long-term interests). There is also a need to look beyond the static benefits associated with TNC operations and to seek to generate dynamic comparative advantage. This type of firm-specific policy will be best operated at the local level, but a Community framework is needed to prevent beggar-thy-neighbour policies between countries.

- The third set of reasons for a Community policy on inward investment is similar to that argued by the United Nations for strategic FDI policy, namely, the need for transparency and coordination, and for ensuring that measures are adapted closely to the specific policy goal. On the basis of the earlier discussion, there is no question that the integrated approach proposed presents enormous challenges and may indeed be impractical at present. No policy consensus exists, and there is a danger that agreement on common or coordinated policies in one area will be undermined by competitive bidding in another. To date, however, there has perhaps been insufficient focus on the role and activities of the TNC *per se* within the EC, and particularly its cross-border operations and impact. The generation of evidence on cross-border restructuring by TNCs may help in highlighting the problems created for all EC members by unrestrained TNC operations, and therefore encourage more of a consensus. Ultimately, the cost of not doing so could be the break up of the EC. The principle of subsidiarity is now a barrier to the generation of Community-wide policies, and therefore policy coordination may be all that can be achieved in the near future.

Some ideas for policy change

There is a very strong case on both theoretical and empirical grounds for enhanced supply-side policies designed to *upgrade the human and physical resources* of EC member states. As at present, the emphasis in Community support should be on the poorer peripheral areas and the older industrial areas. To sustain the development towards economic and monetary union, the necessary resource transfers would have to be much higher than at present, which is clearly a problem for the richer countries providing the funds. In any event, despite Community support, national Governments have the major role to play. Part of infrastructure development would consist of sophisticated transport and communications networks, education and training designed to provide new skills and cater for new technologies, and investment in research and development in universities, research establishments and enterprises (together with mechanisms for bringing research to the market in the particular region or country). One of the weaknesses of non-core areas concerns a lack of services, but it should be possible with advanced communications technologies to decentralize some services.

Too little is yet known about the implementation of the EC Merger Control Regulation, in conjunction with Articles 85 and 86, to say whether they represent a possible solution to *competition policy* in the area of transnational operations. The primacy of Community policy over national policy is essential and proposals to reduce the size thresholds for merger evaluation are to be welcomed. It is hoped that the criteria for evaluation will include wider criteria than market efficiency *per se*. Evidence, admittedly limited, from external acquisitions in one peripheral region (Ashcroft and Love, 1993) indicated that, while the internal effects of acquisition were beneficial, the external effects were likely to be detrimental to the growth of the economy. The latter derived from reduced local linkages and a reduction in the quality and range of functions performed by the company locally; associated with this a reduction in senior posts and promotion opportunities. There are pending problems in the treatment of joint ventures as opposed to acquisitions and mergers, with the suggestion being made that legislation as it stands gives companies a strong incentive to draft their cross-border joint ventures as "mergers" (*Financial Times*, 23 February 1993). The problem reinforces the need for a comprehensive approach to cross-border activities of whatever type.

In relation to *investment incentives* and performance requirements, the case for incentive levels linked to the economic situation of different regions seems strong. So does the need for greater transparency, greater guidance on acceptable forms of incentives and greater monitoring. Regular reviews of assisted areas are necessary, as undertaken at present, consistent with the need to provide stability to investors. It should be possible within such a guided framework to reduce the overall level of incentives. This is partly to reduce overall costs to Community and national taxpayers but also because some EC countries (e.g., Portugal) that are permitted to offer the highest rates of grants cannot sometimes afford to do so. Furthermore, there should certainly be attempts to link incentives to the nature of the project as a form of performance requirement (rationalized production affiliates vs. world-product specialist affiliates, at the extreme). Essentially, the EC would sanction different types of FDI attraction activity in different groupings of countries beyond just aid ceilings as a control. These proposals would require much tighter control over regional incentives at Community level, which is necessary to avoid a destructive competitive bidding that benefits only TNCs. There are other issues concerning the targeting of investment projects that are a legitimate activity for national and regional Governments, and these are discussed below. But the Community in its watchdog role might have observations on the compatibility of targeted industries and firms with the growth potential of the regions and comparative advantage. More generally, issues relating to overall industry capacity and the potential displacement effects of inward investment have to be considered.

Linked to the above discussion on incentives for new investment is the critical topic of *divestment rationalization and production switching* by TNCs. Since regional incentives are invariably an issue in rationalization decisions, the Commission would be involved. There is a case for requiring an appropriate consultation period during which information would be obtained from the company and options evaluated.

On the other hand, the competitive bidding process between involved Governments would be restrained. Such suggestions bear some resemblance to parts of the proposed Vredeling directive which was designed to set up formal employee information and consultation procedures in TNCs in the Community (Blanpain *et al.*, 1983; Molle, 1990).[6] As discussed earlier, the reality at present is that

[6]This proposed directive on *procedures for informing and consulting the employees in transnational firms* was introduced in 1980 and was known as the Vredeling directive after the then commissioner responsible for social affairs. Transnational corporations would have been required to explain to their employees the justification for and the legal, economic and social consequences of decisions such as closure or transfer, restriction or substantial modifications in activities, major changes in organization, working practices, etc. The proposal was bitterly opposed by TNCs and employers associations, and failed to gain the necessary support within the Council of Ministers of the EC.

individual EC members have vastly different requirements for worker protection. It is clearly undesirable to propose policies that would inhibit structural upgrading and disadvantage the international competitiveness of enterprises. However, there are grounds for requiring a company contribution to supply-side costs in the event of rationalization or closures above a certain size.

The *performance requirements (local content rules)* imposed upon Japanese investors are obviously discriminatory. Local content rules lead to market distortions by forcing inward investors to operate with higher costs than they would have incurred through imports, although this assumes that foreign imports are made on cost/quality/delivery, as opposed to strategic and perhaps predatory, grounds. In favouring local suppliers the extent of any inefficiencies depends on the degree of competition among domestic firms (Schreyer, 1991). Investment and trade policies towards Japan open up much wider issues than can possibly be discussed here, including access of European producers to the Japanese market, export policies of Japanese firms given the incidence of anti-dumping actions and the attitudes of Japanese TNCs to technology transfer into Europe via local sourcing. It might also be legitimate to ask whether the imposition of anti-dumping duties and local content rules that encourage transplant production do not thereby create greater difficulties for indigenous European competitors than would imports. For the purposes of this article it may be reasonable to assume that the focus is trade as opposed to investment policy, and the debate is essentially about the world-wide problems posed by the "new protectionism". Of course a continuing review of the consequences of voluntary export restraints, anti-dumping actions and local content rules would represent a critical component of inward investment policy.

The intention in the above proposals has been to provide a policy framework to overcome distortions and imperfections in the market system, to prevent abuse of market power, reduce beggar-thy-neighbour policies and provide a more informed and equitable basis for handling TNC dislocations, but not to reduce the scope for *policy initiative at national and regional levels*. The promotion and targeting of investment and the other activities of inward investment agencies through "after-care" remain of great importance. A study undertaken by the Netherlands Economic Institute in conjunction with Ernst & Young (1992) suggested three major policy themes for regions:

- Based on an analysis of their strengths and weaknesses, regions should formulate policies to attract feasible types of activities; this would involve targeting specific industries although not on an extreme basis because of dangers of over-reliance and subsequent problems of restructuring.

- Regions should develop a "rounded package of measures" to implement their chosen strategy successfully.
- Regions should attempt to attract activities that contribute to their longer-term development, that is projects that involve significant training in new skills and technologies, introduce new management practices or technology and/or incorporate research and development or higher management functions.

While desirable, such policies would not necessarily contribute to the attainment of a dynamic comparative advantage which must be a fundamental objective in any strategic inward investment policy in the EC. Unfortunately, the conceptual frameworks are too general to be helpful in suggesting policy direction, and there are few experiences which might demonstrate success in harnessing the potential of TNCs. In essence the challenge is to generate complete value-added chains in particular localities which would make the areas attractive to a range of enterprises and organizations, to attract integrated world product specialist affiliates with their own research and development, manufacturing and marketing capabilities and/or to assist in the creation of industrial clusters, especially in technology, to produce agglomeration economies and set in motion a self-sustaining virtuous cycle of technological and manufacturing development (a review is contained in Young, Hood and Peters, 1993).

Mention has already been made of the possibility of tailoring incentives to the quality of a proposed inward investment project and this should certainly be investigated. The problem is that initial investments often tend to be pilot or at least small-scale ventures, and the evidence relating, say, to the establishment of world product specialist affiliates does not indicate that these are set up from scratch (Etemad and Séguin Dulude, 1986; Young and Hamill, 1992). Monitoring and regulation of incentive offers at the Community level also become much more difficult and open up possibilities for distortions and competitive bidding.

With regard to the development of local linkages, there are a variety of possibilities. One is to identify gaps in supply industries and weaknesses in supplier capabilities and then to provide extensive technical and financial support to indigenous firms to remedy these. This can only be undertaken at the regional level and requires the existence of a sophisticated development agency with a range of specialist expertise available. In one case where the latter exists in the form of the Scottish Development Agency/Scottish Enterprise, efforts over a long period of time in the electronics industry have been very disappointing, with locally sourced items consisting mainly of relatively bulky, low value, simple technology components (Turok, 1993). Another possibility is to utilize TNCs themselves to stimulate local supply industries. It is neither desirable nor feasible to operate local content rules down to the national or regional level, but incentives could be made available to support approved initiatives. The experience of some Japanese companies in Europe indicates a variety of company-supported initiatives, including encouraging new entrant suppliers as wholly owned subsidiaries or joint ventures, assisting company employees to set up supply firms and initiating supplier development programmes (Oliver, Morris and Wilkinson, 1992).

A different option, and a variant on the theme of investing in infrastructure, requires heavy public investment in research and innovation in universities, research institutes and enterprises, clustered in or around science parks and the like, with the purpose of generating innovation, entrepreneurship and dynamic linkages and creating the climate for advanced TNC operations. This is undoubtedly a critical area of policy, one which is much wider than simply inward investment and one where much work remains to be done. In the context of this article, however, the key issue is still how to link the capabilities of TNCs and the human and physical resources of host countries and regions to produce dynamic gains for both sides.

In terms of *implementation*, the suggestion made by the United Nations (UN-TCMD, 1992) for an investment review mechanism, in this case at the EC level, could represent a way ahead. Its role would be to consider all aspects of cross-border investment activity, to scrutinize implementation of the different policy strands and to receive reports from countries and regions. Given the need for a policy consensus, progress would be iterative, with the investment review agency having a purely *coordinating* role initially but thereafter progressing to a *monitoring* and then to a *decision-making* role. In the same way, the agency's involvement in policy formulation would evolve: at the outset, activities would be restricted to *coordinating* measures developed by other arms of the Community; at the second stage the agency could have a role in *strengthening* measures; and at the third stage, it might have a *widening* role, bringing in other policy components. In the third stage, monetary and fiscal, trade, technology and energy policies would be integrated as envisaged in Dunning's (1992) macro-organizational framework. A policy evolution that paralleled in some way the steps towards economic and monetary union would be logical.

Regarding the scope of the proposed policy, both EC and non-EC TNCs would be included. To ensure that the programme was manageable, size thresholds would need to be set. These criteria would require to relate, first, to the size of the TNC as a whole and, second, to capital investment and employment where internal expansions, contractions and restructurings were involved. The existing size thresholds for competition policy, and the criteria developed in the context of the former Vredeling directive, could clearly form the basis for discussion on this issue.

A number of the points developed in this article have been the subject of consideration at the EC level in the context of the Commission's ambitions for a "Europe of the regions" for the twenty-first century (Commission of the European Communities, 1991b; Amin and Malmberg, 1992). The aspiration is to establish a supranational authority to be responsible for Community-wide physical planning, as part of a comprehensive strategy for the development of European cities and regions. What is being proposed here focuses on the TNC and regional disparities as key elements, and is hopefully less rigid, permitting corporate flexibility and regional initiatives, as well as reflecting the need for a policy consensus if progress is to be made.

Conclusions

This article has presented the case for a European Community policy on inward investment, recognizing that this is only a partial approach which, desirably, would be included within a much wider framework for TNC policy both in the EC and globally. Progress towards economic and monetary union has been and will continue to be slow and hesitant. There are many reasons for this, but differences in economic performance between member states are a fundamental barrier. Coincidentally, a number of the major differences exist between *central* and *peripheral* countries and regions, and the progress of integration itself might accentuate these differences and inequalities.

As has been shown, TNCs do promote integration through their cross-border operations. On the other hand, TNCs may be a force that exacerbates centripetal tendencies in the Community. The restructuring activities of large TNCs, moreover, are not only dislocative, but pit Governments against each other as they attempt to anchor foreign direct investment within their boundaries. An EC policy for inward investment and TNCs is thus an important means of harnessing the potential of these firms to promote European integration. It would at the same time facilitate intergovernmental cooperation at the micro-level and policy coordination across different divisions within the European Commission, two elements which, *inter alia*, are also essential if progress is to be made towards economic union. ■

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