

Chapter 2

The EU in the Global Economy

2.1 The EU Between Globalization and Integration Processes

Investigation of whether and to what extent the EU has been participating in the ongoing globalization process is not an easy task because globalization is a complex phenomenon and Europe has played a complex role in it.

Today, it is widely acknowledged that globalization has several dimensions – economic, social and political/institutional – and that each of them is the result of a myriad of effects which raise distinct issues and have distinct consequences. When discussing globalization, therefore, it is important to carefully distinguish among its different forms.

Economic globalization – the aspect on which this book concentrates – can be defined as a process whereby domestic products, capital and labor markets become more integrated across borders. This is not a new trend but rather a historical process, because nations were involved in more extensive and complicated relations even before the modern era (Baldwin and Martin 1999). Nevertheless, the current wave of globalization has characteristics which distinguish it from the previous ones: in particular, the technological progress that has improved the speed of transportation and communication while lowering their costs, economic policies marked by the deregulation of service industries, and the elimination of restrictions on international trade and investments. Deregulation has involved several types of action, ranging from the removal, simplification, or reduction of government restrictions to the privatization of state-owned firms and liberalization of several industries, while trade liberalization has been pursued both multilaterally through successive GATT/WTO negotiations and regionally, bilaterally or unilaterally through the action of an increasing number of developed and, mainly, developing and emerging countries.

Another recent trend, facilitated by the falling costs of trade and the development of information and communication technologies, concerns changes in production methods. Components and parts can be easily and cheaply shipped across the world and assembled where required. Production processes can be unbundled and located across the globe in order to exploit the economic advantages arising from differences in factor costs and availability, as well as from investment climate (Amiti and Wei 2005; Yi 2003; Hanson et al. 2005). The growth of these global

production networks has been more marked in high-tech industries and in labor-intensive consumer goods. Recently, it has also become significant in service sectors, where technological progress has made it possible for services such as software development, financial services, and call centers to be supplied from different countries around the world. Consequently, trade now occurs more within than between industries, and countries tend to specialize more in activities that cut across industries than in specific final goods (Baldwin 2006).

Europe has played a significant role in shaping the past and current waves of globalization. It has been a source of technological progress, as well as of liberalization policies and practices that have often anticipated global trends.¹ The emergence of the single market as an outcome of the integration process has further enhanced both trade and investment, which are usually complementary activities.² More specifically, increasing liberalization and competition have led to an increase in the cross-border penetration of economic activities, because European Union firms may choose among a wider set of locations within the integrated single market. The latter has also increased the scope for the rationalization of production and the building of regional integrated networks that enable multinational firms to take advantage of local supply differentiation, free intra-firm trade, and lower cross-border coordination costs (Cantwell and Piscitello 2002). There is consequently no doubt that whilst Europe has made the world economy more “global”, globalization has changed the structure of the European economy.

This chapter deals with these intertwined phenomena. Unfortunately, we cannot explore all of the dimensions of globalization, not even when considering economic globalization alone. Consequently, we focus on the two most important and visible aspects of the latter, i.e., the dynamics and the main characteristics of patterns of trade and FDI. Before the analysis begins, some clarifications are necessary. Firstly, when we discuss the characteristics that globalization has assumed in the EU, we consider patterns of extra-EU trade and extra-European inflows of FDI. In so doing, we implicitly assume that globalization concerns the integration of the EU as a whole in the world economy. Although patterns of intra-EU trade and FDI are important in quantitative terms, they are instead considered as the most direct consequence of the widening and deepening of the European integration process. By comparing the two phenomena, we show that they are not always complementary. Secondly, in dealing with the characteristics of these flows, we focus on quantitative changes at both aggregate and sectoral levels, rather than on qualitative variations in such flows. Therefore, at the end of this chapter the reader will have gained greater awareness about the relative size and

¹We refer here, for example, to the liberalization of service sectors, which has been faster in Europe than under other preferential trade agreements, such as NAFTA and MERCOSUR.

²The complementary relationship linking FDI and trade has been highlighted at theoretical level by Mundell 1957, Helpman 1984, Helpman and Krugman 1985 and Baldwin and Ottaviano 2001. Empirically, the results are contradictory, although several authors demonstrate that a complementary relation is more likely than a substitute one. See, among many others, Fontagné 1999, Blonigen 2001 and Egger and Pfaffermayr 2005.

importance of the current globalization wave and the position of the EU with respect to its main competitors in the world. Qualitative changes are difficult to capture at aggregate level, since globalization may exert opposite effects at both country and region level, according to the specific socio-economic characteristics of each territorial unit. These important changes will be subjected to thorough discussion in Chap. 3, when we start to consider a regional perspective.

2.2 International Trade Patterns

2.2.1 *The International Framework*

The shift of trade policy toward more openness and the rapid economic growth of the emerging countries have resulted in new geographical and sectoral patterns of trade. Over the past two decades, international trade has expanded at record rates, with world exports rising by more than 6% per annum in real terms. This expansion has been partly driven by innovation in information technology and liberalization of several markets around the world, either in merchandise or in the service sectors.³ Despite the small contraction of trade recorded in 2001 because of the burst of the new economy bubble, the average expansion of world trade has remained high, averaging 7.5% for the period 2001–2007. It has well outpaced the expansion of GDP, which has risen at an annual rate of about 3% throughout the period, and 3.3% in the 2000s (Fig. 2.1). Global imports have followed a similar trend. Over the period considered, in fact, imports of goods and services grew at an annual average rate of about 6.6%. In real terms, global imports increased from about USD 3,000 billion to more than USD 11,000 billion.

Both merchandise trade and trade in services contributed to the expansion of global trade. Not surprisingly, trade in services grew faster than merchandise trade, bringing global trade in services from about USD 423.5 billion in 1985 to USD 3,700 billion in 2007 (Fig. 2.2), when trade in services accounted for about 21% of global trade, 3% points more than its share in the mid-1980s.

Trade expansion did not occur uniformly across the globe. The most dynamic traders were industrialized countries, namely the European Union (EU),⁴ the United States (USA) and Japan (Fig. 2.3), which accounted, and still account, for about

³Worth mentioning here are the formation of NAFTA in 1994 and MERCOSUR in 1992, the disintegration of the Council of Mutual Economic Assistance (CMEA) after the fall of the Berlin Wall in 1989, and the entry of China into the WTO in 2001.

⁴By “European Union” we always mean the current 27 member-states of the European Union, regardless of the period of time under consideration.

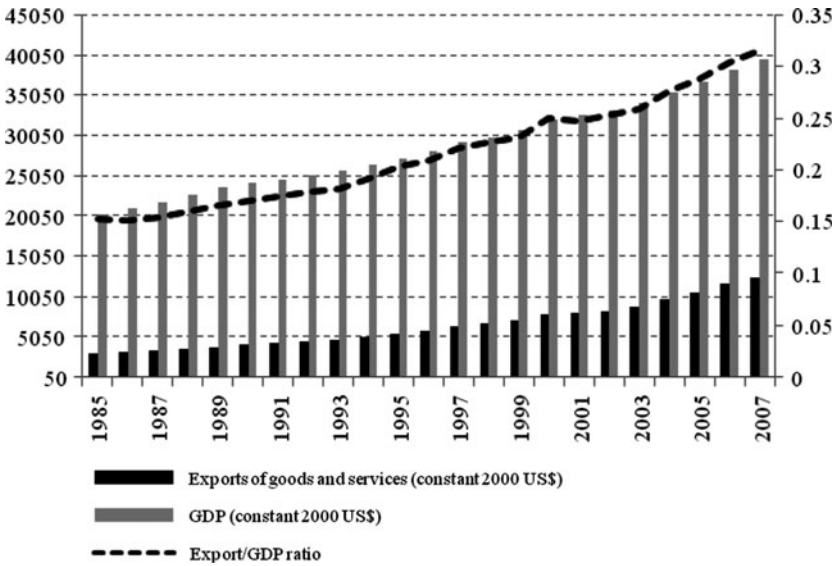


Fig. 2.1 Trends of world trade (based on exports) and GDP, 1985–2007

Source: Authors' calculations on WDI

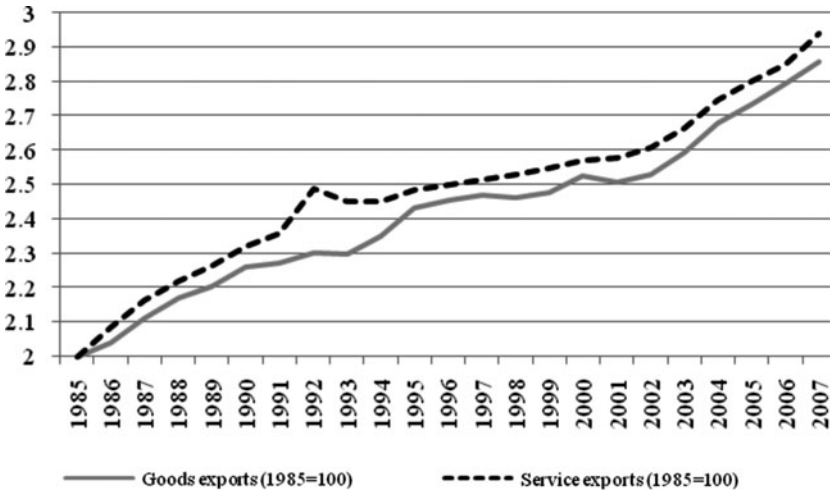


Fig. 2.2 Trends in world exports of merchandise and services (1985 = 100), 1985–2007

Note: vertical axis in logarithmic scale

Source: Authors' calculations on WDI

50% of total world exports. However, to be noted is that while the United States and Japan saw a strong deterioration of their world market shares, the EU was able to increase it.⁵

⁵These figures include both intra- and extra-EU trade.

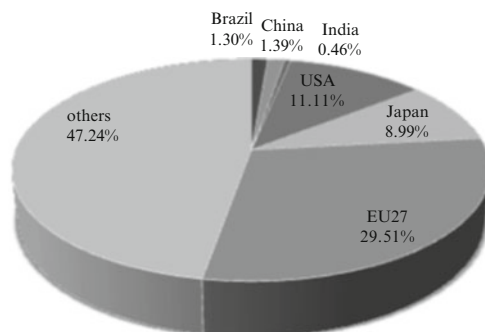
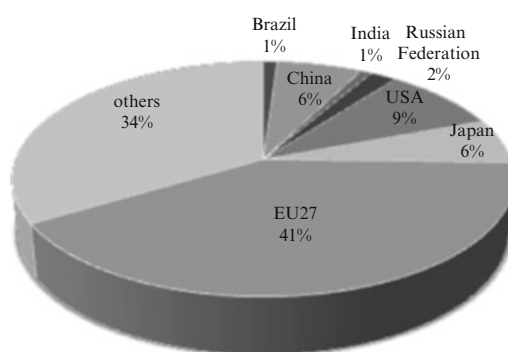
1985**2004**

Fig. 2.3 Distribution of world exports by regions, 1985 and 2004

Source: Authors' calculations on UNCTAD data

The decline in Japan's and the USA's export shares was mainly due to the competitive pressure exerted by the emergence of new competitors, firstly the Asian newly industrialized countries and then China, the recovery of the CIS and the other BRICs, and more recently to the boom in commodity prices, which boosted the export shares of Africa, the Middle East and Latin America and Caribbean countries, which export mostly raw materials.⁶ Increased competition from emerging countries in the world merchandise trade was initially concentrated in labor-intensive products, such as textiles and clothing. It then expanded rapidly in more technological intense products, such as consumer electronics and information technology goods.

Preferential trade agreements (PFTs) produced mixed effects on international trade flows. The stimulus provided by the NAFTA was not sufficient to reverse the

⁶The acronym BRICs was created to denote Brazil, Russian Federation, India and China. Several other variants exist, according to the emerging countries included. Recently, 'BRIICS', i.e., Brazil, Russia, India, Indonesia, China and South Africa, has also come into use (see OECD 2009).

decline in the share of the USA, while the European integration process, which continued to deepen and expanded to cover an increasing number of countries, was able to sustain and further strengthen the relative position of the EU in the world economy – as the next section will show in detail.

The prominent role played by industrialized countries in world merchandise exports is linked to their very large share in exports of manufactured goods, which is the most demanded product category, but whose importance has reduced over time, from about 83% of total merchandise trade in 1995 to 73% in 2008. Four categories of merchandise have been identified within manufacturing: raw materials, labor-intensive, capital-intensive, and research-intensive goods.⁷ Given the skewed nature of this classification, it is not surprising to find research-intensive goods dominating the ranking at world level, followed by labor-intensive goods, which experienced a decline in world trade over the period considered. Raw materials, instead, tend to become more important over time, although the sharpest increases have been recorded in the new century, reflecting either the increase in world demand or the increase in prices of commodities. The other two categories of goods are, in general, stable over time, although their patterns have not been constant. In particular, the share of research-intensive goods increased sharply until 1999, when it reached the peak level of about 52% of total world trade, and decreased again afterwards, returning to the initial level, while capital intensive goods exhibited the opposite trend (Fig. 2.4).

2.2.2 The EU in Global Trade Markets: Intra- Vs. Extra-EU Trade

Since the 1950s, the EU's international trade has achieved a dynamic performance – as shown by Fig. 2.5 – stimulated first by the post-war reconstruction and then by the different phases of the deepening and widening of the European integration process, such as the elimination of all tariff and non-tariff barriers among member states, the introduction of the single currency, as well as the successive enlargements of the EU, especially those to Southern (Spain, Portugal and Greece in the mid-1980s), Northern (Austria, Finland and Sweden in the mid 1990s) and Eastern Europe, which enabled the EU to increase its share of world trade from about 30% in 1985 to 41% in 2004.

These apparently good results, especially if compared with the deterioration in the relative positions of the other countries of the Triad – i.e., Japan and the United States – have been mainly due to the EU's high degree of orientation toward the internal market. Although both intra- and extra-EU trade flows have constantly increased since the beginning of the integration process, the former have achieved growth rates above the world average, while the latter have grown at rates close to

⁷This classification is based on Akyüz 2003.

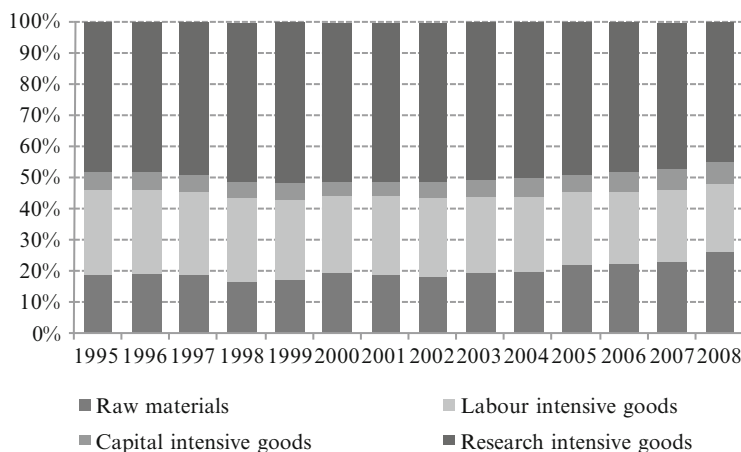


Fig. 2.4 The composition of world trade flows (exports)

Source: Authors' calculations on UNCTAD data

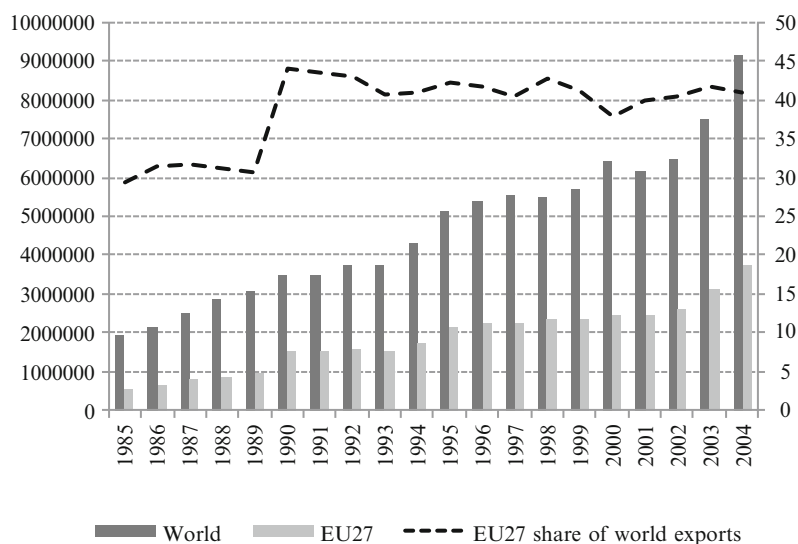


Fig. 2.5 The EU's export performance at world level, USD millions and percentage

Source: Authors' calculations on UNCTAD data

or below the world average. Consequently, the shares of extra-EU exports and imports on global flows decreased from 20 to 25% in 1950 to about 12 and 14% in 2006, respectively.

Therefore, once intra-EU trade is controlled for, the performance of the EU in the world market becomes quite similar to that of the other old industrialized countries. Hence, the EU has not been able to cope with the pressure of external

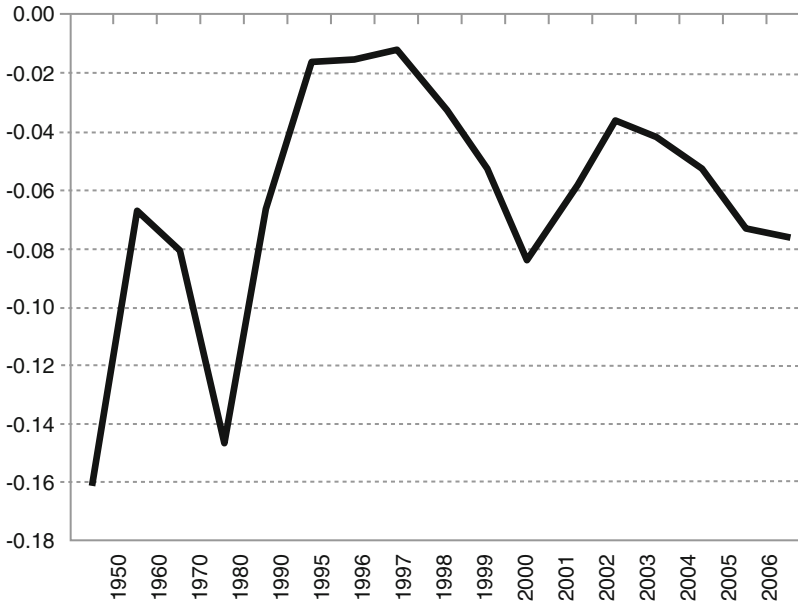


Fig. 2.6 EU external trade: normalized trade balance

Source: Authors' calculations on UNCTAD data

competition and the influence of the dynamism of newly-emerging trading powers.⁸ The deterioration of the EU's relative position in global markets is also visible in its trade balance patterns: the EU is still in large deficit with the rest of the world, and its position has again worsened since 2000 (Fig. 2.6).⁹

The ongoing globalization process has also affected the geographical patterns of extra-EU trade (Fig. 2.7). APTA countries – China, India, Bangladesh, Korea and Laos – have become increasingly important as destination and origin markets for EU trade since the end of the 1990s, while EU trade with NAFTA has significantly reduced, although the latter is still the main market for extra-EU exports and imports. Because of these changes, the EU has accumulated large and rising deficits with most of its extra-EU trading partners, and mainly with Asian and South American emerging countries; deficits only partially compensated by the surplus

⁸Preferential Trade Agreements (PTAs) have been among the distinctive characteristics of the present wave of globalization. However, their effects on trade flows of integrated areas vary across the globe. Of course, the main differences concern extra-group trade flows and the relative position of each group in world trade. In particular, PTAs have enabled ASEAN and APTA to strengthen their positions at world level, while weakening those of NAFTA and MERCOSUR. Hence, PTAs have been complementary to globalization in Asia but have substituted it in Europe and America.

⁹The normalized trade balance is the ratio of the trade balance to the total value of trade (exports plus imports). It varies between -1 and 1 , and it is equal to zero when exports are equal to imports. Therefore, the normalized trade balance gives a synthetic measure of the degree of disequilibrium of trade flows and its normalization makes it a suitable instrument for comparisons over time and space.

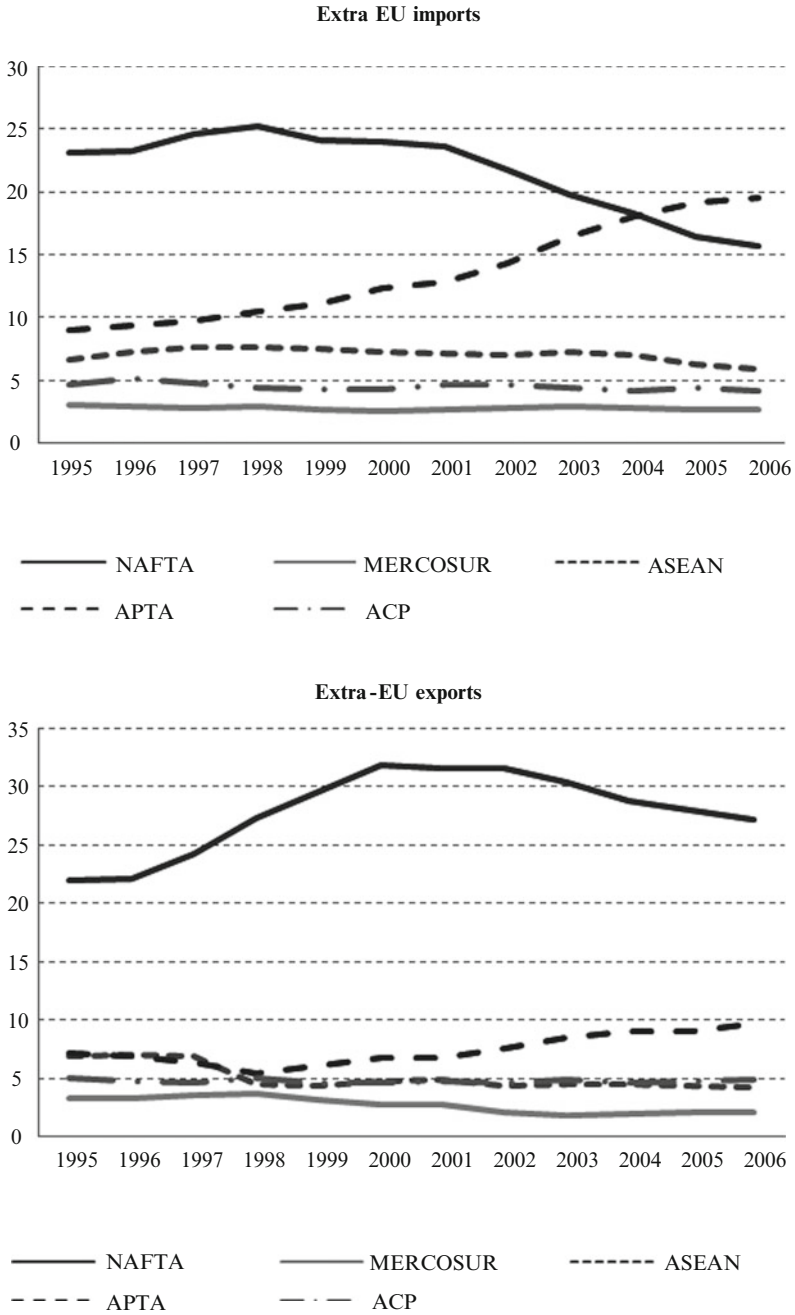


Fig. 2.7 The EU’s main trade partners
Source: Authors’ calculations on UNCTAD data

Table 2.1 The EU and its competitors: structure of export flows and shares of world markets

	World	Mercosur	Nafta	Apta	Asean	EU	Acp
1995							
Raw materials	19.05	44.09	18.96	11.20	23.87	13.66	53.86
Labor-intensive goods	27.12	23.13	20.09	46.54	22.34	29.04	26.22
Capital-intensive goods	6.19	11.70	4.53	5.08	2.71	7.12	10.16
Research-intensive goods	47.64	21.08	56.42	37.19	51.08	50.19	9.76
<i>Total</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>
Raw materials	<i>100.00</i>	3.44	16.58	3.77	7.75	29.47	4.74
Labor-intensive goods	<i>100.00</i>	1.27	12.34	11.02	5.10	44.01	1.62
Capital-intensive goods	<i>100.00</i>	2.81	12.19	5.27	2.71	47.26	2.75
Research-intensive goods	<i>100.00</i>	0.66	19.73	5.01	6.64	43.31	0.34
<i>Total</i>	<i>100.00</i>	1.49	16.66	6.42	6.19	41.11	1.68
2006							
Raw materials	22.78	47.22	19.69	7.90	25.39	13.80	67.37
Labor-intensive goods	23.09	16.74	19.77	35.58	17.99	24.57	13.27
Capital-intensive goods	6.38	9.31	4.34	5.84	3.05	7.04	9.93
Research-intensive goods	47.76	26.73	56.20	50.68	53.56	54.58	9.44
<i>Total</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>	<i>100.00</i>
Raw materials	<i>100.00</i>	3.44	11.96	4.33	7.12	22.81	6.65
Labor-intensive goods	<i>100.00</i>	1.20	11.85	19.23	4.98	40.06	1.29
Capital-intensive goods	<i>100.00</i>	2.43	9.42	11.42	3.06	41.58	3.50
Research-intensive goods	<i>100.00</i>	0.93	16.29	13.24	7.17	43.01	0.44
<i>Total</i>	<i>100.00</i>	1.66	13.84	12.48	6.39	37.64	2.25

Source: Authors' calculations on UNCTAD data

which characterizes the EU's trade relations with NAFTA countries and, in particular, the USA.

The persistent nature of these deficits raises concerns regarding the existence of structural deficiencies at technology level. In this regard, Table 2.1 gives a breakdown of the main international trade flows (based on exports) by merchandise categories and by regions. When the EU's performance is compared with that of other regional country groups, several interesting facts emerge. On the exports side, the EU¹⁰ was able to maintain its share of the world market for research-intensive goods stable during the period considered, while it lost positions in all other world markets. On the imports side, instead, the EU lost ground in all categories, although the smallest reduction was recorded by research-intensive goods. These facts indicate that the EU was able to cope with the challenges raised by globalization. However, to be noted are the impressive improvements made by APTA countries, which almost doubled their export shares in capital and research-intensive goods.

In order to gain better understanding of the EU's relative position vis-à-vis the other world competitors, we also computed a measure of revealed comparative advantage (RCA) based on trade balances, in order to take the effects of business

¹⁰We refer here to both intra- and extra-EU trade.

Table 2.2 Revealed comparative advantage

	Mercosur	Nafta	Apta	Asean	EU	Acp
1995						
Raw materials	109.86	21.95	−61.74	48.07	−32.50	141.63
Labor-intensive goods	22.72	−34.33	116.45	14.22	5.61	10.29
Capital-intensive goods	38.55	−0.27	−12.35	−22.13	1.80	27.29
Research-intensive goods	−171.13	12.65	−42.36	−40.16	25.10	−179.21
2006						
Raw materials	120.19	−7.47	−105.60	10.23	−44.27	190.01
Labor-intensive goods	3.81	−25.98	88.32	8.01	5.74	−44.29
Capital-intensive goods	21.40	−4.69	−1.66	−18.52	0.88	22.10
Research-intensive goods	−145.40	38.14	18.94	0.29	37.65	−167.82

Source: Authors' calculations on UNCTAD data

cycles into account.¹¹ Table 2.2 confirms that most EU resources have been devoted to the production and export of research-intensive goods, followed by labor-intensive and capital-intensive goods. However, while the RCA in the former category has increased over time, those for the other two have remained unchanged. To be noted, moreover, is that in 2006 APTA and ASEAN countries recorded an RCA not only in labor-intensive products but also in research-intensive goods. These figures confirm that new players are emerging in the world arena and that the EU may encounter difficulties in maintaining its competitiveness.

2.2.3 International Trade in Services

Services play a major role in modern economies, and especially in an interlinked globalized economy. Increased trade in services and their availability boost economic growth by improving the efficiency of many other industries, for which they provide key intermediate inputs.

Since the mid-1990s world trade in services has steadily increased by about 8% per year. Consequently, services have maintained their share of about 23% of overall international trade.¹²

¹¹The index was computed as follows:

$$RCA = \frac{1000}{(X + M)} \left[(X_i - M_i) - (X - M) \left(\frac{X_i + M_i}{X + M} \right) \right]$$

This indicates the contribution made to the trade balance by each good category. A positive contribution indicates a “revealed comparative advantage” for that category of goods. By definition, the sum over all categories of goods is zero. This index makes it possible to compare the relative specialization pattern of each factor intensity category within but not across countries. For more details see Freudenberg and Lemoine 1999.

¹²According to figures published by the World Trade Organization, in 2007 world trade (exports plus imports) of goods and services amounted to 28,261 and 6,486 billion USD, respectively.

Table 2.3 Trade in services (export based)

	1995				2006			
	Transport	Travel	Other	Total	Transport	Travel	Other	Total
Percentages								
World	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
EU27 (world)	43.18	44.47	48.01	45.54	45.10	42.72	49.36	46.62
Brazil	0.86	0.24	0.52	0.51	0.54	0.57	0.72	0.64
China	1.10	2.16	1.37	1.57	3.28	4.52	2.56	3.25
India	0.62	0.64	0.49	0.58	1.19	1.15	3.84	2.52
Japan	7.42	1.06	8.23	5.55	5.88	1.13	4.84	4.09
Russian F.	1.25	1.07	0.53	0.90	1.57	1.02	0.92	1.10
USA	14.83	18.50	16.93	16.93	10.67	14.22	16.38	14.51
RCAs (normalized)								
EU27 (world)	-5.01	0.52	4.49		-8.77	-12.23	21.00	
Brazil	-3.32	-41.22	44.54		-24.04	13.51	10.53	
China	-100.28	158.63	-58.35		-56.23	64.32	-8.10	
India	-138.14	135.96	2.18		-159.39	2.02	157.36	
Japan	11.14	-80.86	69.72		3.52	-63.22	59.70	
Russian F.	87.55	-74.86	-12.69		83.82	-81.29	-2.53	
USA	-45.86	8.66	37.20		-62.78	7.30	55.48	

Source: Authors' calculations on WTO data

Inspection of the different categories of services for which total world figures are available shows that, between 1995 and 2006, travel and transport services as shares of total world exports decreased by about 8 and 3% points, respectively, while the share of other commercial services, which include business services, increased by 11% points, up to 51% of total world exports. Increasing fuel prices and the perceived lack of security in many world areas had a significant effect on transportation costs.

The EU remained the world's largest trader of services, with a share of total world trade well above 40% over the period considered.¹³ It was followed at a considerable distance by the USA (13%) and Japan (about 5%). However, while Japan and the USA saw their aggregate shares decrease, that of the EU slightly increased. The most impressive changes were recorded by China and India, which more than doubled their shares in world service transactions over the period (see Table 2.3).

These aggregate figures hide some differences across countries. In particular, the EU recorded increasing surpluses in all service categories, transportation included. Also the USA ran persistent surpluses, with the exception of transportation services, whose trade imbalance worsened over time. Brazil, China and the Russian Federation showed increasing deficits, while toward the end of the period India turned deficits into surpluses in all categories but transportation, exhibiting increasing specialization in service activities.

¹³Data refer to both intra- and extra-EU trade in services. According to Eurostat, when intra-EU trade in services is not considered, the EU's world market shares become 28% for exports and 24% for imports.

Also in service sectors, the EU has a strong orientation toward the internal market, with 58% of the EU's total trade in services occurring between EU-member states. This share has decreased over time, however, suggesting an enhanced interest in markets outside Europe characterized by lower production costs, a large and still unexploited resource potential, and more dynamic user demands. Nevertheless, the EU shows consistent surpluses in external transaction in all categories of services but travel. Extra-EU trade in services is mainly directed toward North America and, in particular, the USA.

2.3 Spatial Patterns of FDI

2.3.1 *FDI at World Level*

Recent decades have seen two important waves of increasing FDI inflows at world level – the first occurring in the mid-1980s, the second in the mid-1990s – driven by worldwide sustained economic growth, an acceleration of technical progress, especially in information and communication technologies, as well as privatization programs and liberalization of new markets around the world. The EU has been a major player in these waves, since they have coincided with three important milestones of the European integration process: the single market program, introduction of the Euro, and Eastern enlargement. Despite the cyclical character of FDI flows and their dependence on economic fundamentals, inward FDI stocks in the EU have increased exponentially since the 1980s, reaching their peak in 2007, with more than USD 7,000 billion and a percentage of world stocks of about 45%.¹⁴

Better information on the capacity of an area to attract FDI can be drawn by adjusting inward FDI stocks with GDP. As shown in Fig. 2.8, the EU's capacity to attract FDI has increased over time and surpassed the world average from 1990 onwards. This suggests that the EU has been able not only to maintain but also to improve its attractiveness for foreign investments, despite the emergence of interesting new destinations around the world, such as China, India, and Brazil.

The dynamic of the distribution of FDI inward stocks within EU27 highlights a persistent geographical concentration of FDI across EU countries, while confirming an overall improvement in FDI penetration (Fig. 2.9). In particular, three phases, one for each decade, can be clearly distinguished. In the 1980s, FDI was largely concentrated in a few countries, as indicated by the gap between the minimum and the maximum values recorded, which is always very large, with negative minimums (Cyprus) and maximums (Ireland) exceeding 100. In the 1990s, instead, FDI was more geographically dispersed and thus involved a larger number of countries; while in the 2000s, the concentration again increased, although no negative values

¹⁴See UNCTAD, *World Investment Reports*, various issues for an in-depth analysis of FDI flows and stocks at European and world levels.

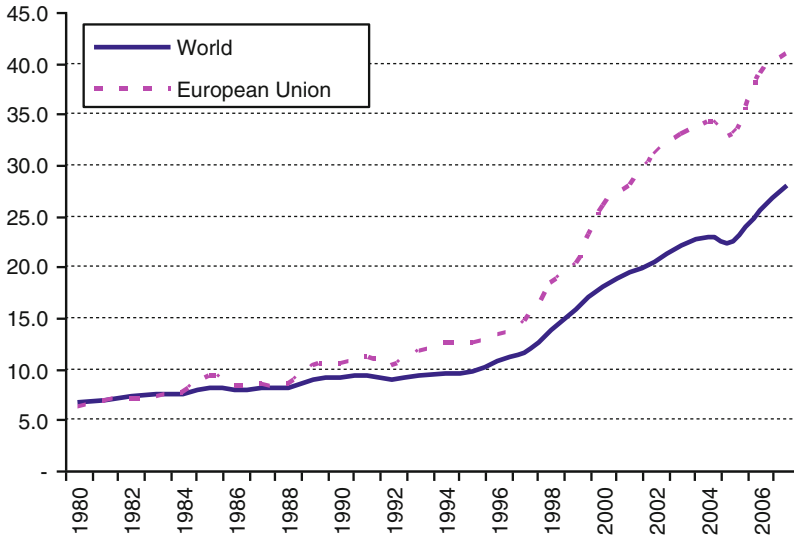


Fig. 2.8 FDI inward stocks over GDP
Source: UNCTAD data

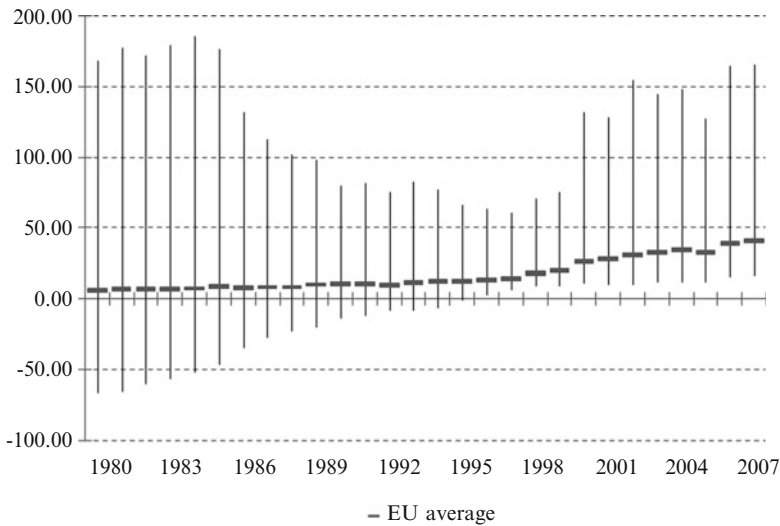


Fig. 2.9 FDI stocks as a percentage of GDP in the EU27, 1980–2007
Source: UNCTAD data

were recorded. These patterns may be explained by the enlargements of the EU, which have opened more and more markets to FDI over time, thus generating inequalities among new and old destinations. Also to be noted is that, on average, FDI penetration has increased over time, especially from 1990 onwards. This trend has

Table 2.4 New foreign firms by periods

	1997–1999	2001–2003	2005–2007
Total number of new foreign firms			
EU27	20,400	96,956	109,155
EU15	17,903	74,964	66,349
EU12	2,497	21,992	42,806
Intra EU FDI			
EU27	58%	62%	67%
EU15	60%	65%	65%
EU12	51%	53%	69%
Main recipient countries			
United Kingdom	23%	42%	32%
Romania	2%	16%	31%
France	14%	9%	8%
Germany	13%	4%	3%
Poland	1%	1%	5%

Source: Authors' calculations on the FDIRegio database

coincided with the opening up of the new markets of Central and Eastern European countries, which have attracted a substantial share of both intra- and extra-EU FDI.

2.3.2 Foreign Firms in the EU27: Geographical Patterns

Although useful for understanding the main facts and trends concerning FDI, international statistics on inflows and inward stocks at country level suffer from many shortcomings and distortions which make them less significant when detailed and more disaggregated analysis is conducted on the structure and evolution of foreign investments at sector and region levels. Information drawn from the FDI Regio dataset is instead much more useful for this purpose because it allows analysis of activity by multinational enterprises (MNEs) with reference to the economic sector, its origin within or outside Europe, and the location within each destination country.¹⁵

As expected, FDI penetration in the EU has increased over time, given the progressive liberalization of markets and the reduction of transportation costs which make it easier and more efficient for firms to exploit new production strategies based on off-shoring and outsourcing abroad. During the period considered, the number of new foreign firms established in the EU27 grew from 19,410 in the 1997–1999 period to 109,155 in the 2005–2007 period (Table 2.4). About one-third of these firms originated from non-EU countries. Globalization in Europe is

¹⁵The FDIRegio dataset has been compiled on the basis of the Amadeus database. Annex 2.1 provides more details on the FDIRegio dataset, including the main variables, its primary sources and the criteria used to construct it, its major advantages and shortcomings with respect to official aggregated data, as well as its level of significance in explaining general trends in FDI.

therefore more regional in nature, being sustained by the internal integration process. This trend has strengthened over time, as indicated by the share of intra-EU FDI on total FDI, which increased from 58% at the end of the 1990s to 67% in the mid-2000s.

Nevertheless, the apparent paradox of globalization (OECD 2007) – that is, global industry that is highly geographically concentrated – is confirmed by the EU experience. The geographical distribution of FDI within Europe is in fact very uneven, with EU15 accounting for 61% of total FDI flows and EU12 the remaining 39%. However, it should be noted that, in 1997–1999, only 12% of foreign firms chose to locate in Central and Eastern European countries. The current improvement in the attraction capacity of EU12 is mainly due to Romania, where flows of FDI have recently increased exponentially, driven by the country's improved economic conditions and completion of the reform process. In 2005–2007, the most important FDI recipient countries were the United Kingdom (32% of total FDI) and Romania (31%), followed by France (8%) and Poland (5%).

It is finally worth noting that, although globalization has reduced the importance of where to locate, the geographical concentration of foreign firms tends to increase over time, with two countries collecting more than 60% of FDI flows during the 2005–2007 period.

2.3.3 Foreign Firms in the EU27: Sectoral Patterns

One of the most striking characteristics of the globalization process has been the reduction of the importance of the manufacturing sector and the emergence of the service sector as a pillar of the economic structure of many countries and regions.

FDI is no exception in this respect. The recent liberalization and deregulation of service markets, as well as the rapid expansion of demand in several service markets have opened up new business opportunities in home markets, together with the capacity to expand internationally in certain service activities. This general phenomenon is common to several countries, European ones among them. As the share of FDI in the service sectors has dramatically increased over time, from 58% in the late 1990s to 75% in the mid-2000s, the share of FDI in manufacturing activities has decreased from about 41 to 24% of total FDI in 2005–2007. This pattern is particularly marked in EU12, where FDI in manufacturing sectors accounted for about 60% of total FDI in the late 1990s. Nevertheless, FDI in manufacturing sectors is relatively more important in the EU12 than in the EU15. FDI in primary sectors – e.g., agriculture and mining and quarrying – is still negligible, accounting for less than 2% of total FDI (Fig. 2.10).

Further inspection of the sectoral concentration of FDI highlights the existence of a clear divide between EU15 and EU12 member-states, with the former exhibiting a relative concentration of FDI in the service sectors which is greater than that in the manufacturing sectors (Fig. 2.11). The opposite trend characterizes EU12 countries.

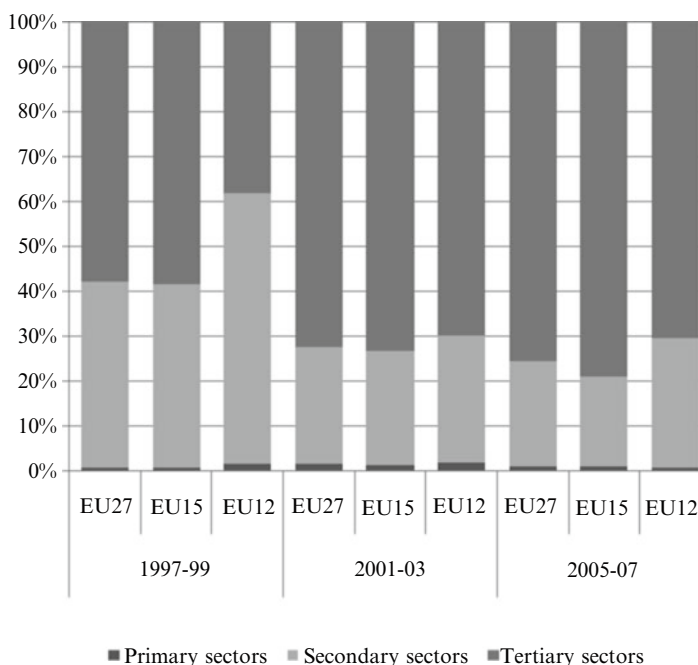


Fig. 2.10 FDI by sectors (percentages)

Source: Authors' calculations on the FDIRegio database

In particular, the Czech Republic, Hungary, Poland, Romania and Latvia have further increased their attractiveness for FDI in their manufacturing sectors, while Bulgaria has improved its position as a potential location for FDI in the service sectors because of its recent liberalization process.

2.4 Conclusions

In this chapter, we have provided a short description of the EU's position in the world economy. The main objective has been to determine whether and to what extent the EU has been able to participate actively in the ongoing globalization process, rather than passively accepting its consequences.

Since globalization is a complex phenomenon, this chapter has focused on its quantitative aspects, while the qualitative ones will be discussed in the next chapter. From a quantitative point of view, we have measured globalization in terms of trade and foreign investments. We have consequently examined the major trends observed in trade in goods and services and FDI and emphasized the EU's position in the world.

From the trade point of view, globalization has increased at consistent rates since the beginning of the period observed. Not surprisingly, trade expansion has been sustained mainly by trade in services rather than trade in goods, and secondly by the

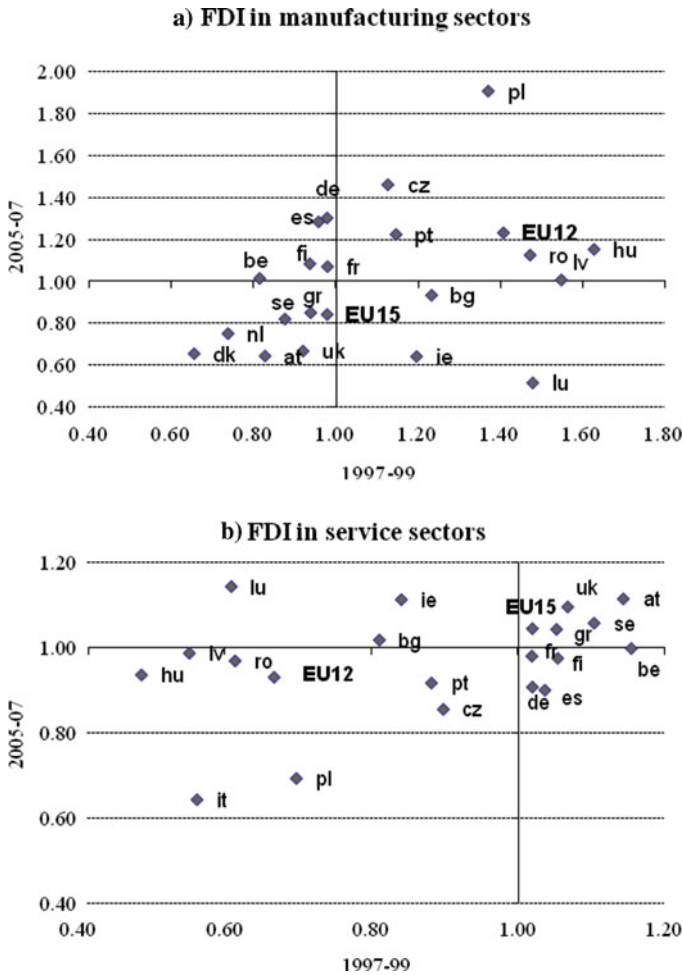


Fig. 2.11 FDI sectoral concentration by country
Source: Authors' calculations on the FDIRegio database

emergence of new players in the world arena, which have gained substantial shares of world trade at the expense of industrialized countries, in particular the United States of America and Japan. Although new emerging countries initially exported massive amounts of labor-intensive manufacturing products, they have rapidly moved to the more valuable segments of the value chain, both in manufacturing goods and in services. This phenomenon, still modest in quantitative terms, should not be undervalued because it may erode the comparative advantage of industrialized countries.

As regards the EU, international trade has been highly dynamic since the 1950s. However, its main engine has been the integration process, in its twofold dimension of horizontal and vertical integration, rather than closer integration with the rest of

the world, although this has always been supported with liberalizing policies both in trade and foreign investment.

The deepening of the integration process, especially between completion of the single market to adoption of the single currency, has exerted a strong effect on the EU's capacity to attract FDI from outside Europe, while the enlargement of the EU has created numerous new business opportunities for Western European firms, which have been able to regain competitiveness and efficiency through the delocalization of production as a whole, or of vertical stages of it, to Central and Eastern European countries.

From a sectoral point of view, the composition of FDI in the EU has changed over time, following the changes brought about by globalization: foreign firms providing services have become increasingly numerous, while the share of foreign firms producing manufacturing goods has diminished over time. This change is more apparent in Central and Eastern European countries, although these still remain particularly attractive to foreign manufacturing firms. Because of these patterns there seems to be a divide in the EU, with Western European countries increasingly specialized in services and Central and Eastern European countries in manufacturing FDI. The nature of these patterns, their determinants and possible consequences on the performance of EU regions will be explored in the following chapters.

Annex 2.1 FDIRegio Dataset: Its Structure and Its Consistency with Official Data

In this book, we use firm-level information on inward FDI. The data are taken from the Amadeus database compiled by the Bureau Van Dijk (<http://www.bvdep.com>). The database consists of company accounts reported to national statistical offices concerning 11 million public and private companies in 41 European countries. For each company the database provides the year of creation, the country/region, and the ownership structure by nationality. The data also include the region where the firm was founded, as well as its sector of activity. Foreign firms were selected when they were newly created during the periods considered, i.e., 1997–1999, 2001–2003, and 2005–2007 and when the percentage of assets owned by non-residents was at least 10%. We also considered all EU27 countries as host countries, while distinguishing between European and non-European foreign investors.¹⁶ For the first period, there were no data available for Cyprus, Malta and Slovenia, while for the second one only Cyprus and Malta were missing. Moreover, in the 1997–1999 period no foreign direct investments were recorded in Estonia, Lithuania, and Slovakia.

A limitation of this database when studying the geographical patterns of foreign firms is that it contains either plant or firm level information. This may bias the

¹⁶We also considered Norway, Iceland, Liechtenstein as European investors because they have signed agreements with the EU which allow them to participate in the single market without being members of the EU.

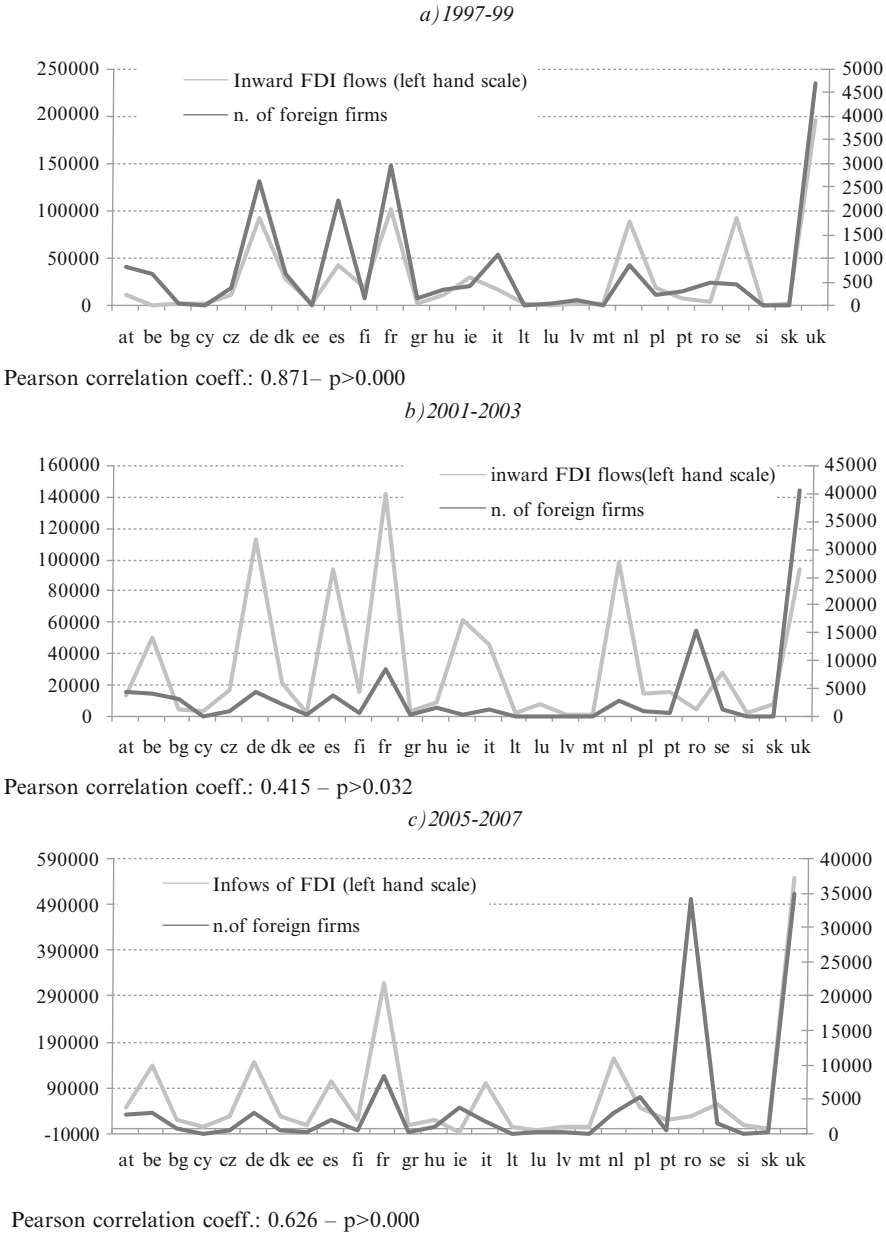


Fig. 2.12 Number of foreign firms vs. inflows of FDI
Source: FDIRegio database

location of FDI in favor of regions and/or countries where headquarters tend to locate. But an advantage of this approach is that it is not necessary to estimate the regional distribution of foreign firms starting from national data. This top-down approach, in fact, is based on the simplifying assumption that the sensitivity of foreign firms to employment data – or whatever is used to regionalize patterns of FDI – is constant across foreign firms, regardless of the internationalization strategy that they pursue (efficiency, market, and resource-seeking FDI), the country of origin and the role that foreign affiliates may play within the group (productive vs. research units).

Comparing UNCTAD data on inward FDI flows with the total number of foreign firms extracted from Amadeus following the criteria just described shows that the correlation between the two measures of FDI flows is quite high in all periods, as indicated by Fig. 2.12. Thus, by considering the number of foreign firms instead of values of FDI, we do not introduce any significant distortion into the sample, although foreign investments in some destination countries have a relative importance that is different in terms of the number of firms with respect to the value of FDI inflows.

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