

Hans Tson Söderström (ed)



**PAPERS AND PROCEEDINGS FROM AN  
INTERNATIONAL CONFERENCE**



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*Center for Business and Policy Studies*



**One Global Market**



# **One Global Market**

Effects of the Internationalization of Markets for Goods,  
Capital and Labor on the Corporation and Public Policy.

Papers and Proceedings from an International Conference  
arranged by SNS - Center for Business and Policy Studies  
for SNS Counterpart Organizations in Saltsjöbaden,  
Sweden, 30 - 31 August, 1988.

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SNS – Center for Business and Policy Studies

- SNS Studieförbundet Näringsliv och samhälle  
SNS – Center for Business and Policy Studies
- SNS is an independent forum for the free exchange of ideas on economic and social issues among individuals in the Swedish business sector, political sphere, public administration, interest organizations, media and scientific research.
- SNS is engaged in academic research, nonpartisan policy studies, consulting to the private and public sectors, publishing, seminars and conferences. These activities are financed through individual membership and corporate fees, research grants, consulting fees and book sales.
- SNS is not affiliated with any political parties or interest groups, but maintains close contacts with the academic community, and with counterpart organizations and similar institutes in other countries.
- SNS was established in 1948 as an independent non profit association of concerned individuals in the business community. It currently has 40 local chapters (of which eight outside Sweden) comprising about 4 000 individual members and approximately 135 corporate members, including most of Sweden's largest corporations in the private and public sectors.

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One Global Market

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# Preface

On the occasion of its 40th anniversary, SNS had the honor of hosting the 1988 meeting of its Counterpart Organizations. In line with a long standing SNS tradition, the Organizing Committee decided to devote the conference to an open exchange of views between business leaders, academic scholars and policy makers on a topical subject of mutual interest to the business community and other sectors of society – but this time on an international scale.

No subject matter could be more natural for such an international meeting than the causes and consequences of the process which is gradually, spasmodically – and sometimes painfully – linking our economies together into One Global Market.

The importance attached in Sweden to various aspects of this topic and to the high level international representation at the conference was born out by the participation of leading representatives from different sectors of Swedish society and by the presence of His Majesty the King of Sweden.

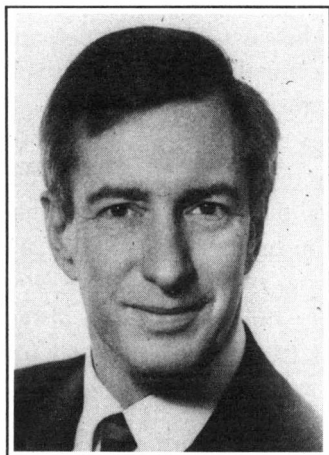
Several of the speeches at the conference were delivered without intention of subsequent publication. It turned out, however, that all the presentations were of such quality and general interest that they deserved a much broader audience than could be gathered at Saltsjöbaden. A decision was therefore taken after the conference to document it *in extenso* from manuscripts and edited transcription of tape recordings.

On behalf of the Organizing Committee, I would like to thank speakers, commentators and staff of all the Counterpart Organizations for their helpful participation in the documentation process as well as for their contributions to two days of candid, informative, and thought-provoking discussion in the true spirit of our organizations.

Stockholm in April 1989  
Hans Tson Söderström  
Executive Director of SNS



# Opening of Conference



*Sven H Salén*

Chairman,  
SNS Board of Trustees

Your Excellencies, Mylord, Ladies and Gentlemen.

I am both extremely privileged and very happy to welcome you here, to this conference, to SNS, and also, for many of you, to Stockholm. We are particularly happy that so many distinguished guests from abroad have found it worthwhile to come here to join us for this event. I hope you will think likewise when you leave us. I am also pleased to welcome some of the "young Turks" who were involved in the process of founding SNS in the late 40s and early 50s, now present, of course, as very senior Turks. And I hope that they will grant us that SNS continues its activity with the same open mind, and the same disturbing inquisitiveness as they desired when it was started.

I would like to say a few words about the venue. You are now at the gate to the archipelago which is the sea of islands, that stretches from here to the west and south coasts of Finland. It is one continuous area. The archipelago of Stockholm starts here, where land is still the dominating force. If you travel about 8 miles south-east, you will find yourself in the heart of the archipelago, where land and water are equally balanced. As you move further east, the sea takes over, the islands become smaller and smaller, and eventually you enter the realm of fish and seabirds, where you are a guest welcomed on their terms. I

hope some of you who have travelled here will take the chance of seeing some of this after we have completed the conference. You may be excused if at times you find yourself gazing out through the windows towards the islands. Please feel free to do so.

But if you are excused in doing so may I be excused for the perhaps overly didactic suggestion that as you look out the window, you will see not only this world of islands where the act of creation is still unfinished. Some 30 000 years ago this area was under a huge cap of ice. Now like a tennis ball that is gradually regaining its shape, as the pressure applied by a thumb slowly relaxes, the land is imperceptibly rising, new islands are being formed at the outer edge, and we are gradually witnessing, the inexorable mysteries of creation. What you see, I suggest, is not only a beautiful piece of nature, but possibly also a metaphor for the societies that we are going to discuss so intensely for the next two days.

We are living in an era of change. Admittedly, this is one of the academic world's most shopworn platitudes but nevertheless it retains considerable truth. Although the change that goes on here may be hard to see, it is still very dramatic, sufficiently dramatic to change the pattern of landscape within one man's life. Our societies are changing, inexorably, sometimes very dramatically, and perhaps even rapidly. This change is a prerequisite for progress. We would not be where we are, we would not enjoy the standards of living, we would not have had the opportunities to create the democratic societies that we now have, unless we had already lived through an enormous era of change. At the same time, this creates severe stress in society. We do not know how much change a single man can cope with in his lifetime, even less do we know how much change institutions can cope within what is or could be their lifetime. We are said to be living through a crisis of institutions in many of our highly developed societies. This is simply because the landscape ahead of us, is new. Our institutions were designed for what is now behind us. Consequently, I think it is a highly worthwhile pursuit to sit down as we do, in a circle of organizations that have their roots in the business community, because business must either cope with change in order to make a living in that era of change, or die. Public institutions are hard to kill. Sometimes a little euthanasia in this sphere would be very welcome. However, there has to be an interaction between the various parts of society. This interaction illustrates the types of change that are required. Society is always thought of as being

organized in various orders. Back in time, we had three orders, those that prayed, those that carried the sword and the rest of us who tilled the soil. The basic division of labour still exists although under different guises. Business, at least at present, is thought of as one of these orders on which society is founded.

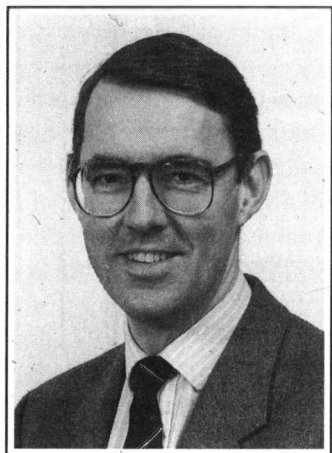
For this reason alone, there has to be an intelligent interaction between the business community, the public domain, academia, the cultural sphere, etc. I will leave to you to decide the actual composition of society today. However all the various orders will have to interact. Consequently organizations such as SNS, and their sister organizations abroad will, in my view, fulfil a very important role. One of them is to help to generate the social innovations, the new structures and institutions that can work in a changed and rapidly changing industrial society.

There is another pass-word, that comes to my mind when I see the broad and very challenging programme of one global market, because this is one of the most fundamental changes that occurs in all our highly developed societies. The fact that we are increasingly influenced, day by day, by the close-knit links, in the commercial and other spheres, between our societies. That word is dependence. Since we increasingly interact with one another, we also become, to a growing extent, dependent on one another. Dependence has different connotations. Some people think it is very disagreeable to be dependent on anyone, or anything. Independence is the best of words. I grant it is a fine word, but dependence is very much a part of the human condition. From our infancy to the final days of our lives, we are dependent on others, whether we like it or not. In the sphere of business and politics, this growing dependence is frequently deplored, because it is said to reduce the sovereignty of the national state. This may be the case and I leave it to you to decide on whether this is good or bad. However I think it is clear that the national state is no longer the strong motivating force that it once was. These motivating forces occur on the one hand at the supranational level on the other hand at the subnational, regional or local level. This may be troublesome for those who have the responsibility for the administration of the national state. However I do not think that there is much that can be done about it. The way in which the global market sets the conditions for development, both at the supranational and the subnational lever is one of the areas which in my opinion will require close examination during this seminar.

We are dependent on one another. Well, if that is so, I think the best frame of mind, is to sit back and enjoy it. I hope therefore you will find that the temporary dependence that we are creating between all of us here, will be enjoyable to all of you.

This is a jubilee. I am already abusing my role here in opening this seminar. A jubilee often gives you a reason to do things, or say things, that should properly be said without such a pretext. I think it is fitting for SNS and its experimental spirit that we are celebrating this jubilee with an experiment. We have never done this before, I hope that you will help us assess at the end of the conference, whether it is worthwhile to try again. It is this experimental spirit which is, I think, the essence of SNS.

May I thus once again wish you all welcome and ensure you that we are very happy to see you here. The conference will now finally start and I will hand over to SNS' executive director, Hans Tson Söderström.



*Dr Hans Tson Söderström*  
Executive Director SNS

Ladies and Gentlemen.

Let me then also say a very warm welcome to all of you as participants in the SNS international conference, "One Global Market". We are very pleased to see with us today a rich representation of those Swedish top business leaders who normally convene at this time of the year in Tylösand to discuss some topical social issue under the auspices of SNS.

But in particular, I would like to say a special welcome to Trustees and Research Staff from all our counterpart organizations around the world. We feel very honoured that so many of you have answered our call and decided to share with us some of your precious time. We hope and believe that your decision will be amply rewarded in intellectual and social currency during the course of this conference, which marks the 40th year of activity of our organization.

It should be said from the very beginning, I think, that this conference is an experiment. *Within* each of our organizations we all attempt to create a dialogue – or triologue, perhaps – on various policy issues between business leaders, academics, and senior public officials. We also hold regular staff meetings *between* the counterpart organizations to discuss our research projects, common problems and ideas. But – to the best of my knowledge – this is the first time that we have attempted to create a truly international exchange of views between business leaders, academics and public officials from all the counterpart organizations.

Of course, there are significant differences between these counterpart organizations. Some encompass almost all the large corporations in their respective countries – other are more exclusive in scope. Some put a heavy emphasis on research and publications – other are more oriented toward providing a meeting place and giving voice to policy statements by Trustees.

But more important than differences are the similarities. All the counterpart organizations serve those business leaders in their countries who have a deep and personal concern for the future of *all* society – not only their own narrow business interests. These organizations are meeting points for people with an open mind, with a respect for the opinion of others, and with a willingness to listen to their views. We organize those business leaders who prefer to study the results of academic research *before* they form their own opinion. Our organizations have been created by business leaders who like to get the questions right before they start looking for answers.

We had no problem in finding a theme for this conference which would be of interest for all the counterpart organizations. All of us can see the continuing integration of world markets not only for goods and services but also for capital, labour, technology, and entrepreneurship. This integration – which proceeds quite independent of political decisions – is dramatically changing the environment for decision making

in firms, organizations, and nations. We see "footloose" industries locating production wherever seems fit from a judicial or fiscal point of view. We see corporate raiding and hostile takeovers on a worldwide scale. We see a gradual erosion of national autonomy in economic policy making.

The purpose of this conference is to help us get a better understanding of this process of globalization. The logic of the program is to discuss its pace and consequences, market by market. After an introductory overview we first look at trade policy and the markets for goods and services. We then turn to the factor markets; the labour market and the organization of production, and then the global capital market. We end by looking at economic policy making in an internationalized world economy.

We have asked prominent representatives of the counterpart organizations to chair these sessions. Each session starts off with one or two speakers who will present papers on the particular subject. The word then goes to a panel of Trustees from different counterpart organizations for a panel discussion. At the discretion of the chairmen, this panel discussion will gradually turn into a general discussion where one minute interventions from the floor are invited.

The concluding session has a somewhat different format. There, leading representatives of five counterpart organizations will form a panel to summarize what we have learnt from this conference, and what the implications are for our organizations. To the extent that time permits, short interventions from the floor will also be invited during this session. Without anticipating the results of that discussion, I would like to conclude by saying that – to my mind – this conference is in itself a manifestation of the theme of the conference. The corporations that many of you lead are becoming more and more global in scope and activity. The *problems* that we meet within the corporations or in their environment are also becoming global in character. The *solutions* and policy recommendations that we make must also become increasingly global.

Therefore, to serve the needs for which they have been created, our *organizations* must also become global. This first experiment with a global conference must be followed by many more. But also our research projects, our publications and our policy recommendations must in the future have a much more global character. This is a major task that lies ahead of us. A few first steps in that direction would be a

useful material result of the two days during which we are gathered here in Saltsjöbaden.

With these words I would like to leave the floor to the chairman of the first session: Ed Fitzgerald, chairman and CEO of Northern Telecom, who has just recently stepped down as chairman of the Board of Trustees of the Committee for Economic Development in the US after many years in that position. He and Bob Holland, president of CED, more than any other individuals personalize the idea of a closer international collaboration between our counterpart organizations. We are very happy to see both of you here today.

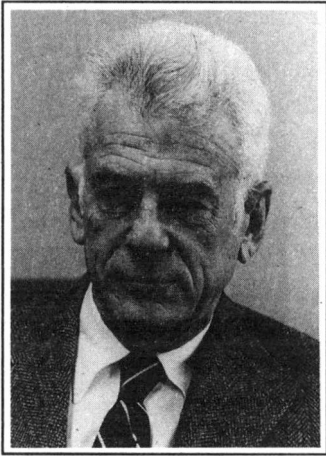


SESSION I  
Trade Policy and Integration  
of Markets for Goods  
and Services

*Chairman: Edmund B. Fitzgerald, CED*



# New Challenges for the Global Economy



*Isaiah Frank*

William L Clayton Professor of  
International Economics, The Johns  
Hopkins University  
CED

It is a great pleasure for me to address this distinguished group of representatives of counterpart organizations at a conference in which the theme is "One Global Market".

The increasing integration of the global economy has been a powerful force for world economic growth. It has fundamentally altered the way nations interact in both the public and private sectors. Studies begun by CED suggest that, whereas leading businesses have for the most part adapted to globalization, governments have frequently intervened in order to counteract it or control its consequences. The private sector groups assembled here can have an important impact, therefore, in influencing their respective governments toward policies that encourage rather than resist the further integration of the world economy.

I shall focus my remarks on four basic aspects of the present world trading order: (1) the implications of the huge U.S. trade deficit; (2) the accelerating trend toward the globalization of markets and production; (3) the current effort in GATT to improve and modernize the trading rules for an increasingly integrated world economy; (4) and the changing leadership role of the U.S. in attempting to influence the evolution of the global trading system.

## U.S. Trade and Current Account Deficit

I hope you will forgive me for beginning with what may sound at first like a parochial U.S. problem. I refer, of course, to our massive external deficit. For each of the past couple of years the U.S. has imported approximately 150 billion dollar of goods and services in excess of its exports. Although the deficit has been declining in recent months, the continuing imbalance remains a serious problem, and not just for the U.S. By fueling strong protectionist pressures at home, it has cast a dark shadow over the entire world economy. It must be corrected if progress is to be made in adapting the international trading system to the new and far-reaching trends in the globalization of markets and production.

Many in our Congress see our huge trade deficit as reflecting primarily unfair trade practices in other countries and, to a lesser extent, shortcomings in the ability of U.S. firms to produce quality products at competitive prices. While these explanations may apply to particular industries and products, the available evidence indicates that they account for no more than a small fraction of the total U.S. trade deficit.

Actually, the U.S. trade deficit is primarily a macroeconomic problem rather than a trade problem. It represents an excess of U.S. expenditure over output. The federal budget deficit, combined with traditional levels of private consumption and investment, has meant that, as a country, we have been living beyond our means. This excess spending then spills over into a huge net inflow of foreign goods, financed by borrowing savings from countries like Japan and Germany that are in current-account surplus.

As a cumulative result of several years of excess domestic spending financed by borrowing abroad, the U.S. has been converted from the largest creditor country in the world to the largest debtor. Our foreign debt of 400 billion dollar is already twice the combined debt of the two largest LDC debtors, Brazil and Mexico, and the figure may well rise to 1000 billion dollar before it levels off.

Foreign indebtedness on this scale poses two problems: a long-term one and a more immediate one. The longer-term problem is the depressant effect on future U.S. living standards of the need to service this debt. Sooner or later, we will have to run large trade surpluses in order to accomplish the real net transfer of resources implied by the interest charge on our foreign debt.

The more immediate problem, however, is the danger that foreigners

will cut back on their net flow of investments in dollar assets because of a loss of confidence in the U.S. ability to correct its external imbalance without a further sharp depreciation of the dollar. As a result, U.S. interest rates could rise to a level that pushes the nation into a severe recession. The resulting unemployment would add force to the powerful protectionist pressures already being generated by our trade deficit.

How can we avoid this outcome? In recent years domestic demand has grown more rapidly than domestic output. Our main strategy must be to reverse this relationship and bring the growth in U.S. domestic demand *below* the growth in domestic output so as to make room for a substantial shift of resources to net U.S. exports. There are essentially three ways in which the U.S. could do this: increase private savings, cut back on private investment, or reduce the budget deficit. Of these options, the first (increase private savings) is unrealistic in the short-run and the second (reduce private investment) would be counterproductive. We certainly should not reduce private investment at a time when we need to create the additional capacity to produce enough high-quality exports and substitutes for imports to correct the trade imbalance.

That leaves the reduction of the U.S. budget deficit as the principal mechanism for eliminating the trade deficit and correcting the world payments imbalance. More expansionary macroeconomic policies on the part of other countries, particularly Germany, would help. But the prime responsibility lies with the U.S. In addition to reductions in expenditures, substantial additional revenues will be needed, preferably in the form of new taxes that fall primarily on consumption. Only by confronting this problem resolutely, can the U.S. expect to restrain protectionism and elicit the cooperation of other countries in achieving more rapid and sustained economic growth.

## The Move to a Global Economy

Our ability to run large budget deficits for years without crowding out private consumption or investment reflects the global integration of financial markets that has enabled the U.S. temporarily to draw upon the savings of others. Today the pool of saving is world-wide, and intermediaries that mobilize those savings for use by borrowers are not confined to national boundaries.

The internationalization of finance is but one aspect of a larger transformation in the world economy that has been going on progressively over the past twenty-five years. Various terms have been used more or less interchangeably to describe this phenomenon: the globalization of markets; the increasing integration of the world economy; growing international economic interdependence. Whatever the terms used, the essence of what has been occurring is a steady diminution in the economic significance of national political boundaries. Today the economic links and interactions between nation states have become so close that the distinction between many domestic and foreign transactions has all but disappeared.

Broadly speaking, two developments underlie the increasing integration of the world economy. One is technological: the explosive advances in the speed and effectiveness of international communication and transportation and the shrinkage in their real cost. The other is economic: the reduction of national barriers to the international movement of goods, services, technology and capital.

As a result of these developments world trade has grown far more rapidly than world production. There is scarcely a market in the industrial countries today that is untouched by developments in other countries. Even producers who are inclined to think in domestic terms and who are not seeking foreign market opportunities, can be jolted by the realization that their successful counterparts in other countries are thinking globally. Consequently, the competition they face at home comes from foreign as well as domestic firms. Few businessmen or farmers today can afford, therefore, to be unconcerned with such things as exchange rates and the state of the world economy. Government policies abroad as well as at home inevitably affect competitiveness and profitability.

Another fundamental change in the structure of world markets is the emergence of rapidly growing economies in the Third World. This phenomenon reflects, in large measure, the speed with which new technology is spread and the broadening of the range of countries in a position to absorb it. The world-wide diffusion of technology has been facilitated by direct foreign investment by multi-national firms, by international licensing agreements, by exports of advanced machinery, and by the training of students from developing countries in universities and laboratories in the developed world.

Before the debt crisis erupted in 1982, the trade of the industrial

countries with the developing countries had grown to exceed one-quarter of their total world trade. Whereas markets in the developed countries are maturing, the potential for rapid growth in trade with the newly industrialized countries (NICs) is very great. This is widely recognized in the case of the East Asian countries, but less so now in the case of Latin America. However, the current debt crisis does not diminish the long-term potential for growth in this sizeable market.

Higher standards of living and more rapid economic growth are among the benefits of expanding trade under an open global trading system. These results come not only from the *static* gains brought about by the more efficient use of a country's *existing* resources. At least as important are the *dynamic* gains from the stimulus to investment, learning and entrepreneurship that comes with expanding markets and exposure to new products, new technology, new ideas and new standards.

At the same time, however, the more open global trading system has exposed industries in the developed countries to severe competitive pressures. As a result of rapid industrialization in many developing nations, comparative advantage in some industries has shifted away from the developed countries. In the case of the United States, this natural economic movement was accentuated in the first half of the 1980s by the policy-induced overvaluation of the U.S. dollar, which adversely affected the international competitive position of U.S. industries across the board.

The overvaluation of the dollar during that period has been extremely damaging. Although there is no substitute for sound domestic economic management, international coordination of macroeconomic policies can help avoid such exchange rate misalignments or mitigate their effects.

Companies engaged in manufacturing increasingly think of the advantages of alternative world-wide locations rather than purely in terms of domestic production. The globalization of production has two principal dimensions. One is the direct investment in a foreign affiliate, frequently in conjunction with local partners. Much of this type of investment has been induced by the need to leapfrog actual or expected import restrictions in order to sell in a large or rapidly growing local market (e.g. IBM in Mexico, Honda in the U.S.). Increasingly, however, foreign investment is motivated by cost considerations favoring the establishment of an export base abroad for the purpose of selling pro-

ducts both to the home market and to third-country markets (e.g. Xerox in the Far East). In addition, firms in sectors such as banking and consumer products establish affiliates abroad in order to service local markets more effectively.

The second dimension of the internationalization of production is the growing trend toward sourcing abroad for individual processes and components within a chain of production. Examples are the purchase by U.S. auto companies of engines from Brazil or the assembly of U.S. electronic components in plants located across the border in Mexico. The intermediate components and foreign processing may come from affiliates of the parent company as is common in electronics. But in other industries (e.g. apparel) they are often imported from completely independent firms, thus differentiating the relationship from the traditional foreign direct investment model. The ultimate stage in this process is reached when firms import final products from foreign competitors and attach their own nameplates to them (e.g. the Dodge Colt from Mitsubishi). In the automotive and electronic sectors particularly, the nationality of a product is becoming increasingly elusive.

Globalization of markets, production and finance accelerates structural change in national economies. Some industries grow very rapidly while others stagnate or decline. But such change, however painful to particular groups when it occurs, has always been an integral element of social and economic progress. In his book, *The Rise and Decline of Nations*, Mancur Olson shows that a country that blocks structural change does so at its peril. His thesis is that stable and aging societies develop a form of sclerosis as entrenched interests defend outmoded industries and occupations.

## The Uruguay Round of Trade Negotiations

If countries are to accommodate to the forces of change rather than resist them through protectionist measures, the public must have faith that the world trading system is operating fairly and efficiently. Today there is a widespread feeling that the system that has evolved under the General Agreement on Tariffs and Trade (GATT) is no longer adequate. U.S. unease is clearly reflected in an omnibus trade bill passed last month by an overwhelming vote in both houses of Congress. The new law mandates vigorous U.S. action against "unfair" trade practices

while at the same time providing authority to reform the system in a new GATT round of negotiations.

The reduction of tariffs in successive GATT rounds unmasked, and to some extent gave rise to, other barriers, many of which are even more restrictive of international trade. Moreover, the rules no longer serve as a restraint on national actions as governments ignore or violate them with increasing frequency. In addition, GATT does not adequately reflect such major changes in the world economy as the exceptional speed of technological change, the rapid industrialization of many developing countries, and the increasing importance of the services sector. Finally, GATT as an institution has not lived up to expectations as a mechanism for disciplining the behavior of its members and for resolving disputes between them.

If the erosion of the GATT system is to be stemmed, these shortcomings must be corrected in the ongoing Uruguay Round of trade negotiations. Without a strengthened GATT, the world could lapse into the unilateral and nationalistic policies that prevailed during the thirties and contributed to global economic stagnation and depression.

The current round of negotiations is the eighth in the past forty years. Part of the rationale for the successive rounds has been a basic lesson of experience: without an ongoing negotiation to *reduce* barriers to trade, domestic political and economic forces are overwhelmingly weighted in the direction of *increasing* the barriers. In addition to strengthening the GATT system, therefore, multilateral trade negotiations at this time are an instrument for shifting the initiative in trade policy from protection to liberalization.

The agenda for the new GATT round comprises four major subjects:

1. "Liberalization" or the further reduction of trade barriers including not only tariffs but other restrictions as well, especially import quotas and "grey area" measures such as "voluntary export restraints."
2. Strengthening existing rules that have proven inadequate in practice such as those pertaining to subsidies, safeguards, and agriculture.
3. Adopting new rules to cover aspects of trade not previously addressed in GATT; such as trade in services and intellectual property protection.
4. Institutional reform including dispute settlement and ways of integrating newly industrialized countries more fully into the world trading system.

Whether a more open global trading system can be achieved and main-

tained depends to an important extent on the results of the present round of GATT negotiations.

The importance of achieving and preserving a more open global trading system is underscored today by the debt crisis in the developing world. With commercial lending to the heavily indebted countries virtually at a standstill, there is no way that they can pay the interest on their debt except by running trade surpluses. Until recently they have succeeded in doing so mainly by compressing imports as part of IMF-supported austerity programs. As the emphasis shifts from austerity to the restoration of growth, the required trade surpluses will have to be earned through export expansion. To the extent that world markets are limited by various forms of quantitative restrictions, this strategy will meet with frustration.

Resolving the debt problems of the developing countries and reducing the U.S. trade deficit are essential to a more balanced and healthy world economy. But both imply a willingness on the part of the present trade-surplus countries, especially Japan and Germany, to curtail their surpluses. It would be unfortunate if this surplus reduction were to be accomplished through new trade restrictions by the deficit countries because those could slow world economic growth and lead to cycles of protectionism. A far better approach is for the main trade-surplus countries to introduce not only more expansionary macroeconomic policies but more open access to their markets for the products of developing countries as well as those of the U.S.

## The Role of the United States

Over the past four decades U.S. leadership has been critical to world progress in removing national barriers to trade and investment.

So much has been written recently about the decline in the international economic position of the United States that a few words may be in order to place the subject in perspective. As stated in a recent study by Lipsey and Kravis, "despite all we have heard in recent years about the low rate of investment and the slow growth of the United States, this country still enjoys a per capital output that is the highest or close to the highest among the developed countries."<sup>1</sup> The contrary im-

<sup>1</sup> Robert E Lipsey and Irving B Kravis, *Saving and Economic Growth: Is the United States Really Falling Behind?*, The Conference Board, New York, 1987.

pression may be largely a result of the distortions in international comparisons of GNP that result from converting data in different national currencies into dollars by means of market exchange rates rather than by purchasing power parities.

If one focuses on economic growth rates rather than on absolute levels of per capital income, the U.S. has clearly lagged in the post-war period behind Europe, Japan, and many countries of the Third World. But the lag may be in good measure a reflection of the historical phenomenon of convergence, causing nations that were previously behind in their *level* of productivity to grow faster than the leader. Lipsey and Kravis conclude their study with the observation that "the closest major pursuers still have a way to go to catch up technologically, and they may find the remaining gap harder to close than the initial one. In the meantime, the race is benefitting both the leaders and the pursuers."

Nevertheless, U.S. economic supremacy has unquestionably been eroded. As the nation has shifted from the world's largest creditor to the world's largest debtor, the question can legitimately be raised whether the U.S. can continue to exercise leadership in building and preserving an open system for global trade and investment.

The danger in the current situation is that there is no other country likely to assume the mantle of leadership in the world political economy. Even if Japan were willing to do so, it has been habituated to a low-profile role in the international arena and, in any event, few countries are as yet ready to become followers of Japan. As for the European Community, no single country is of adequate size, and, collectively, most decisionmaking by the Community requires the agreement of Twelve sovereign countries, hardly a prescription for decisive leadership.

However, if the U.S. is to continue to exercise leadership, it will need to do so with more attention to the positions of its trading partners. It will also have to resolve not only the problems of its budget and trade deficits but several contradictions that have become apparent in recent years in its own trade policy. While calling for more open markets, the U.S., like many other countries, has continued to take protective actions on a wide range of products — e.g. sugar, textiles, apparel, steel, machine tools. While endorsing *multilateralism* and non-discrimination as fundamental trade principles, the U.S., again like many other countries, has negotiated *bilateral* restraint arrangements with a large

number of its trading partners. And while espousing reciprocity as a basic principle for negotiating *reductions* in trade barriers, the U.S. has invoked that principle in threatening to *increase* barriers against particular countries deemed unilaterally to be engaging in unfair trade practices. In effect, the traditional trade-liberalizing principle of reciprocity has been converted into the trade-constricting policy of retaliating.

As the world economy becomes progressively integrated, however, I believe the U.S. will find it in its interests to resolve these contradictions in favor of the more outward-looking alternatives. The historic alignments between protectionists and liberal traders have been breaking down, and the high costs of protection are becoming more widely recognized. Moreover, despite recent lapses, the U.S. market remains more open to foreign trade and investment than that of any other major country in the world. Once decisive action is taken on the budget deficit, therefore, the U.S. will be in a strong position to exert its leadership more effectively in moving the world toward a more open system of international trade and investment.

# Comments by a panel of Trustees



*Barry Aldrich*

Director, Buckmaster  
Hawkey Ltd.  
CEDA

Mr Chairman, it is not easy to comment on a paper of such broad sweep, and one on which I confess, to an almost total agreement. Perhaps therefore it has occurred to me to make one remark only and that is as Dr Frank pointed out, we are talking here about the tension between the inevitable thrust towards the integration of markets, on the one hand, and the resistance to that tension that comes from the national state. It is perhaps tempting to make that sound easier than it is, or to make the national state sound more evil and backward than it is. It is perhaps a consequence of economics that one tends to label the world, or parts of the world, as either good or bad.

But the national state, and perhaps this might be the only time that this is said in this conference, also has its purpose and its virtues. They must also not be overstated. This is the device by which we, each in our part of the world, organize ourselves, organize our society, in ways that represent and cope moderately well on occasions; with our diverse languages and cultures, and provide us with law and order. Importantly for the economy, the diversity of the national states provides us with that diversity to which Dr Frank referred. We must be very careful I suspect that we do not do so much integration of our societies, our cultures, our languages, that too little diversity remains. It is this diver-

sity, and the pluralism of the world that ensures the future stimulus of the integrated market. That is a comment which goes outside canvas of Dr Franks paper, but the fact that I am obliged to put my comment in those terms, is a reflection, I think of my support for the major thrust of what he has said.



*Alain Honnart*  
Chairman and CEO  
Valinox  
IDEP

Professor Frank has provided us with a major study of world market integration and the role of the United States. I would wish to congratulate him for the very comprehensive approach of the programme, and the highly synoptic manner in which he presented his material. It is difficult to add any comments. However, as my colleague pointed out, there is one dimension that is perhaps insufficiently studied in the organization of world economy, namely the diversity of culture. I think the exchange between our cultures has created some drastic changes in world markets, and world industry in recent years. I will just take as an example, the idea developed in the United States during the 1950s, of total quality control. This concept was transferred to Japan in 1955, where it was developed and modified within the terms of Japanese culture and philosophy, and resulted in the now famous circles. It was then re-exported throughout the world and became all over the world the key method to motivate companies' personnel. This world exchange of culture has contributed substantially to integration of mar-

kets and the improvement of industrial efficiency and productivity all over the world. I think we should not underestimate this aspect. This leads me on to a question, I trust Professor Frank, being an American, will excuse me if I focus my question on the US problem especially the recent problem of the trade deficit, and the difficulties confronting US industry. During your speech you said that the trade deficit could be explained as a macroeconomic problem. Although you of course mentioned trade practice, it was only considered to apply to exceptional cases. I find this rather surprising.

Let me take just one example. Well, we observe that the cost of a car, made in USA by Japanese subsidiaries is lower than the cost of a car made in Detroit. We must then find a reason which is not due to economic factors. Perhaps the answer lies in philosophy and culture and new methods. When this idea is applied to international trade, I wonder if the cheap selling price of US competitors that is reflected in the US trade deficit could not also sometimes be explained by good ideas, hard work and the better efficiency of some of the competitors. This is a question which is worth some attention.

The second question I would wish to raise is the so called "fair-trading practices" bill, that is supposed to solve the problem presently faced by the US economy. This bill would give the US authorities the right to decide what is fair in trade practice. It is my feeling that it could be a threat to globalisation. As you pointed out, this bill will help to continue the policy of bilateral agreements. If I take the example of steel, which is of course a sector I perhaps know better, and examine the impact of the voluntary restriction agreements, the result would appear to be in a shift in the pattern of trade from Japan and Europe to new countries, like Korea, Mexico, Brazil, without really helping to improve the US industry. It may then be said that the bill would be utilized by the USA to select their partners on arbitrary grounds. Don't you think such a bill which put emphasis to the bilateral approach will induce retaliation from other countries and at the end of the day reduce the volume of world trade?



*Dr Konrad O M Westrick*  
Proprietor of Westrick  
International Management  
Consultants, Bologna/Bonn  
CEPES

In fact Professor Frank, you make it hard for any of us to critically comment on your excellent analysis of some of the consequences of globalisation and integration. I almost fully agree with the analytical part of your work, and support most of the harmonious suggestions that you gave as far as behaviour in a global economy is concerned. However, I would like to briefly, focus on three critical effects that may merit some attention, and I do this as a simple daily operator in this globalising world.

1. For a single company internationalisation and globalization demands a significant presence on all the relevant markets and requires skills and financial resources. These skills may or may not be available in any given structure. Sizeable financial resources, however, normally lead to an unnatural selection in favour of the existing large structures. It will also tend to generate larger units of production. Notwithstanding the possible effects on competition and business from the opening of frontiers, there will be a structural tendency towards oligopolisation in global markets, with all its related problems of close structures, concentration of power, and therefore questionable benefits to customers and the single minor company.

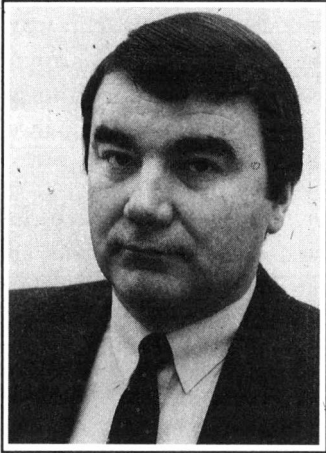
2. I notice an alarming and harmful concentration on a vain search for perfect international coordination and in parentheses equal rights.

This trend seems to be more pronounced anyway, than effective programmes for the development of further specific skills. What is true for micro-economics seems also to be true for macro-economics. In fact, in the paper that has been distributed to us, you wrote that coordination may be desirable in an interdependent world but it is no substitute for responsible domestic economic managements. In a way, you are unable to coordinate developments, you try to influence them your own way. In fact, this is the other side of the same medal. The enormous growth rate of international pressure groups and lobbying, instead of investigating in acquisition or/and development of new know-how, quality, image, notority etc. I find this enormous growth rate somewhat alarming. I will give you just one example. In Germany, for instance, the significant role played by lobbying seems to have become less important or at least less evident. At the same time, in Brussels, the prospect of integration has given rise to a whole lobby industry that is already at full pace.

3. Global markets seem to provide the ideal nutrition for bureaucracy. Globalized markets require many of the regulations mentioned in your paper; financial regulations, intellectual propriety rights regulation, antitrust regulation, environmental regulation, labour regulation, export control regulation, as well as numerous other regulations. The more global the market becomes, the more it requires regulations, national and international. The more regulations there are, the more they require coordination and adaption, which creates a vicious circle. Who has ever enquired about the future nature of the armadas of civil servants who spend their time substituting regulations as well as the coordination and harmonisation of their activities. What will become of those whose work is supposed to render their own work obsolete.

This is only the social, and perhaps the financial part of the question. Most of all, it cannot be generally assumed that these activities will help to develop business over the border. I therefore wonder where the limits of the benefits of coordination and the harm of bureaucracy lie. I think that we here are in a strong, perhaps a uniquely strong position to actively oppose some of the expensive demands of national and international administration.

# Impacts on the World Markets from Punta del Este



*Dr Gerhard Fels*  
Director, Institut der  
deutschen Wirtschaft  
IW

It was almost exactly two years ago when the Uruguay Round was launched in Punta del Este. This is the most ambitious of the eight GATT Rounds so far, with the main subject being reliberalization of world trade rather than tariff reduction. The negotiations are scheduled to be completed in another two years from now. In December of this year the ministers will meet to review how much progress has been achieved. In spite of all the efforts during the past two years it seems that the final objective, i.e. reliberalization of world trade, is even further away now than it was at the beginning of the trade talks. There are no indications whatsoever of a "roll back", nor has there been a "stand still" as was promised originally. In fact, the trade conflict between the United States, Japan, and the EC has rather intensified. According to various estimates some 50 percent of total world trade are today subject to barriers of one kind or another.

While this review of the present situation is certainly disillusioning, one has to admit that the Uruguay Round takes place during a very difficult period for the world economy. The Third World debt crisis has assumed dramatic proportions. The European countries did not suc-

ceed in generating dynamic economic growth and, by doing so, in solving their persistent unemployment problem. Moreover, we have seen pronounced exchange rate variations and large current account imbalances between the U.S. on the one hand and Japan as well as Europe on the other. In this global economic environment protectionism could easily thrive. It is well known, after all, that politicians often resort to trade restrictions in order to cope with unemployment, stagnating markets, structural change, and, in particular, current account problems. Over the past decade several other factors unfavorable to free trade have appeared on the scene:

- Increased international interdependence among the industrial countries has reduced the autonomy of national states. Economic decisions of individual countries have increasingly intense repercussions abroad. A prime example is the U.S. fiscal and tax policy of the 1980s, which was responsible for the American twin-deficits and the resulting exchange rate and interest rate swings. Protectionism basically is an attempt to cushion this loss of autonomy.
- Internationalization on the company level may be even more important. Capital, management, and knowhow have become highly mobile internationally. Even slight differentials with respect to the attractiveness of competing locations may trigger massive international factor movements. Politicians, who tend to think primarily in national terms, are inclined to reduce the increased mobility of companies by protecting the domestic market from foreign competition.

The economic arguments against protectionism are well known and have a long tradition. They extend from David Ricardo to empirical studies by the World Bank which show that protectionism is nothing but counterproductive: it hampers growth and is expensive. In the case of the U.S., for example, the World Bank estimates that 8,900 jobs were saved through import restrictions in the textiles industry. The annual costs to the U.S. economy are \$ 169,000 per job, as opposed to average annual earnings of \$ 12,600 for a textile worker. It would have been much more sensible, of course, to invest these resources in new and modern jobs.

Despite the economically rational arguments against protection the outlook for forceful reliberalization of world trade are at this point fairly bleak. The recent U.S. trade bill, although substantially watered down compared to previous versions, again demonstrates the wide-

spread predominance of protectionist thinking.

Note that the underlying problem giving rise to protectionism can only be solved by attacking protectionism itself. For the productive forces set free by an unhindered international division of labor are an indispensable prerequisite for lasting and dynamic growth. Hence there is no alternative to the spirit of Punta del Este: Reliberalization of world trade. This does not only mean roll back, i.e. removing trade barriers built up in recent years, but also extending free trade principles to areas which so far are not covered by the GATT rules. The most important of those areas are agriculture and services. These are in fact two crucial subjects in the present Uruguay Round.

International trade in services has been growing more rapidly than merchandise trade over the past 15 years. Today services account for more than 25 percent of total foreign trade. Irrespective of their factual importance, however, services up to date have not been subject to a set of international rules. I can see no compelling reason why the GATT standards should not be applied to services as well. Principles like most-favored-nation status, non-discrimination, and reciprocity should govern trade in services as well. The final objective of liberalization of services should be free access to all foreign markets, both in the form of trade across frontiers and in the form of foreign subsidiaries.

Admittedly, the principle of free market access poses more serious problems when it comes to trade in services than trade in goods. The reason is that in the case of trade in services, the conflict between free international trade and domestic economic principles is much more pronounced. Some of the key issues concern national differences in industry regulation, consumer protection, services supplied by public authorities, etc. For example, conflicts regularly arise in telecommunication in countries where that sector is dominated by the state. In this context the EC has recently coined the term "appropriate regulation". It is intended to lead to a better compromise between increasing liberalization of international trade in services and national economic principles. For a transitory period this concept may well be appropriate. The final objective, however, has to be complete elimination of all trade restrictions whatsoever.

The present debate on liberalization of services is also influenced by the general North-South conflict. Many LDCs, most notably Brasil and India, fear that service industries might be swamped by competition from the industrial countries. On the other hand, the ASEAN countries,

Korea and Argentina have shown a lively interest in the service negotiations while there has been little progress on the part of the developed countries. There should be common ground for all parties: By being more cooperative in the service negotiations, the LDCs may get concessions from the industrial countries in the field of merchandise trade, and vice versa.

Agriculture is the other crucial issue. It is no mere coincidence that the majority of violations against the Punta del Este stand still agreement are related to agriculture. A long list of complaints has been piled up in front of the GATT. There seems to be a growing awareness, however, that without progress in the field of agriculture, reliberalization of world trade remains an illusion. In this respect most LDCs agree with the U.S. point of view.

There is a further dimension to the agriculture issue. Trade conflicts between the U.S. and the EC originating in agriculture have spilled over to various other trade areas. In fact, they seem to have a substantial negative impact on transatlantic trade relations in general.

The EC's Common Agriculture Policy with its huge subsidy programs poses the fundamental problem. Even in Europe policymakers are gradually realizing that the CAP needs to be completely reformed. The United States has called for an elimination of all subsidies by the year 2000. The Cairns group, which excludes the three big countries and represents 25 percent of world trade in agriculture, has also made a proposal for phasing out subsidies. The EC, by contrast, is much more reluctant.<sup>1</sup> Hence it is a crucial task for the present GATT Round to come to grips with the agriculture problem. Due to the special sensitivity of this issue one shouldn't expect very rapid progress though. Nevertheless, the GATT parties should not content themselves with vague promises, but rather set a specific timetable which eventually will make trade in agriculture fully subject to the general rules of GATT.

At the same time, liberalization of trade in agriculture is the key to solving another major problem confronting the world economy, namely the Third World debt crisis. According to World Bank calculations the external debt of LDCs totaled \$ 830 billion at the end of 1982; by the end of 1987 that figure had climbed to \$ 1,200 billion.

<sup>1</sup> A remark: The European representative to the GATT commented to the American proposal to eliminate agricultural subsidies by the year is a bit too early; perhaps we should aim at the year 3000.

What makes these statistics so dramatic is the fact that the total debt is by no means distributed evenly among the debtor nations. Rather, a group of only 17 highly indebted countries accounts for two-fifths of all debt outstanding.

There is virtually unanimous agreement that the crisis cannot be solved at one stroke. This applies especially to proposals of comprehensive debt relief. Debt repudiation may only be a viable instrument in the context of development assistance to the poorest nations, most notably in sub-saharan Africa. The general approach to the problem must be to create more opportunities for LDCs to earn the foreign exchange needed to service their debt. This will require better access to the markets of the industrial countries. Agriculture is a key area. Many LDCs have comparative advantages in agricultural production, but they are denied the opportunity to take full advantage of their position.

The GATT is a free trade institution. But it has no authority to enforce adherence to the rules of its members; it operates mainly on a moral basis. In other words, the GATT is basically what its members want it to be. Against this backdrop, one may wonder whether reliberalization of world trade can actually be achieved through institutional reform of the GATT. The Leutwiler report of 1985 proposes the establishment of what might be called a Super-GATT, i.e. a monitoring institution with effective sanction mechanisms for member countries which do not play by the rules. I for one am doubtful, however, whether such a far-reaching proposal has any realistic chance of being accepted.

Regional areas of economic integration, the most important of which is the European Community, by their very nature violate against the GATT principle of most-favored-nation. This violation is particularly dangerous because of the growing tendency towards regionalization of world trade, and the increasing substitution of multilateralism by bilateralism. The EC Commission likes to point out that a large unified market will benefit suppliers from third countries as well, because they will find it easier to market and sell their products in Europe after 1992. The Commission demands that they reciprocally open their markets for imports from the EC as well. In principle, this demand is legitimate, and it does not violate the GATT rules.

But it is rather disquieting when the reciprocity argument gets turned upside down to the effect that third country suppliers are prevented from entering the internal market because of imaginary or real barriers

in their domestic market. It would clearly be contrary to the GATT spirit if the principle of reciprocity was used to justify protectionism at home with protectionism abroad. In the context of the EC trade policy reciprocity in fact seems to be interpreted in the sense of the old testament's proverb "an eye for an eye, a tooth for a tooth".

In the course of completing the EC internal market all controls at intra-community frontiers will be eliminated. As a result, there will be much less scope for individual member countries to pursue national trade policies. So-called voluntary export restraint agreements between an EC member and a third country, for instance, can no longer be enforced by restricting the free flow of the respective products among the EC countries. This leaves basically two options: Existing national import restrictions could either be eliminated altogether, or replaced by common EC restrictions. The latter alternative, of course, tends to intensify the protectionist bias of EC trade policies. Unfortunately, quite a bit of evidence suggests that this second option is more likely to be chosen. This would do substantial damage to the world trading system as a whole, and it would further erode the effectiveness of the GATT.

Some voices have already warned that removing trade barriers in Europe is equivalent to opening the EC market to third countries. Statements which compare 1992 to a Trojan horse handing Europe over to the Japanese are certainly most disquieting. They may give rise to calls for more protection vis-a-vis third countries in order to facilitate domestic adjustment in the wake of liberalization within the Community.

Fortunately, not all EC members favor protectionist practices. The common trade policy is therefore likely to strike a balance between the more liberal countries (Germany, Denmark, the Netherlands) on the one hand, and the more protectionist countries (France, Spain, Italy) on the other. It must be noted, though, that trade policy decisions need a qualified majority in the Council of Ministers, i.e. 54 out of 76 votes. This leaves 23 votes for an obstructive minority. As a result, the free trade faction, consisting of Germany, Denmark and the Netherlands with a combined total of 18 votes, may well be outvoted. It is at least open to doubt whether the majority of EC member states will always support the free trade faction.

In principle, the completion of the internal market could have a strong positive impact on the world economy, on world trade, and

hence on the future of free trade principles. By removing trade barriers within the Community and eliminating numerous national regulations growth could be stimulated vigorously, with large benefits also for third countries through increased exports to the EC. The target 1992 is certainly welcome from the point of view of the world economy – provided that the EC trade policies will not become more protectionist. From this perspective, we should welcome the fact that Europe's trading partners, especially the United States, have introduced the notion of "fortress Europe" into the international discussion. It should be interpreted as a reminder that completion of the internal market must not entail increased protection against third countries.

The year 1992 – the deadline for the internal market – puts time pressure on the GATT talks. The GATT Round must be brought to an end before 1992. By then there must be material progress in the reliberalization of world trade which the EC countries cannot ignore.

# 1992: EEC Internal Market and Third Countries



*Henri Froment-Meurice*  
Ambassador of France  
IDEP

Completing the internal market constitutes the central project of the European Community during the next five years. As defined in the White Paper from the Commission, the aim is to achieve a fully unified market by the end of 1992 and to finalize in five years, in an environment of slow growth, the integration of Europe which has been pursued over a long period of economic prosperity.

The internal policies to be implemented in order to achieve the internal market cover the following areas:

- I Elimination of border controls
- II Standards, tests and certifications
- III Public procurement
- IV Freedom to provide services
- V Competition policy

All these policies which are internal to the community have also external consequences. The creation of a unified market of 320 million inhabitants, which will be the largest in the world, will make it easier for third countries to distribute their products within the Community.

The external aspects of the measures decided require careful analysis.

There is a constant tendency in the preparation of the internal market to treat it as a market of 320 million *consumers* and to give priority to measures favouring these consumers.

Notwithstanding the principles of free trade, it is legitimate to have concern for the future of European manufacturing capacity. Such concern proceeds from the following considerations:

- the heterogeneity of the Community: economic structure and competitiveness vary considerably from one country to another;
- at the level of the Community, the technical and political means are not at the present time commensurate with the magnitude of the project.

The implementation of the internal market will require that common policies, regulations and procedures be developed at the Community level in such areas as standards, public procurement and competition policy. It is essential for the Community to be invested with the means required to place Europe on an equal footing with the other major economic powers and to obtain equal treatment from its trading partners.

With the completion of the internal market, commercial policy will become the sole responsibility of the Community. Therefore all national protective measures and all regional quotas are to be eliminated.

Elimination of quantitative restrictions is excellent in principle but its implementation must take into account the following considerations:

- the need for reciprocity from third countries. In this respect there will be a relation between the Uruguay-round and the definition of the European commercial policy;
- a careful consideration of the sectors which are now enjoying some kind of protection. For most of these sectors, a Community policy will have to be defined which will not in most cases involve quantitative restrictions, but rather support reconversion, defensive measures (anti-dumping, etc), negotiations with third countries;
- give special consideration to the question of investment by third countries with low local content.

Two sectors are especially sensitive: automobiles and telecommunications.

The European automobile market remains highly fragmented as there are still different standards and protective measures on imports from third countries, especially Japan. The economic implications are of course considerable and cannot be ignored when organizing the internal market. The European manufacturers (CCMC) have the following position:

- The maintainance of Japanese imports in the EEC at their 85–86 level until European exports to Japan reach half this level;
- The minimum local content ratio for Japanese plants in Europe is set at 80 per cent.

Telecommunications are also a very critical sector in a world context of deregulation. In most European countries, there is a very close relationship between the network operations and the main local equipment manufacturers. Liberalization of such an industry is a very complex exercise, where reciprocity from third countries will be required.

There is a global need for the development of a European "power", able to defend the interests of EEC countries and to give the European "Space" a specific identity vis-a-vis third countries. It would be to the overall benefit of the Community to allow the Commission to play its role as efficiently as possible by increasing its authority in the conduct of trade talks. Member countries will have to sacrifice elements of national competence.

## Comments by a panel of Trustees



*Dr Monica Düssel*  
Counsellor EEC Affairs,  
Hoechst AG  
CEPES

In my comments I would like to concentrate on the aspect of the EEC Markets and Third Countries. I entirely agree with Mr l'Ambassadeur Froment-Meurice when he said that it is legitimate to be concerned about the future of European manufacturing capacity. But the question, however, is, which is the best way to make sure that European industry does not lose its competitiveness on world markets. The objective of achieving a real internal market is not to keep the current patterns of industry at all costs, by subsidies, and by import restrictions. The objective of the internal market is to accelerate firstly economic growth, and to provide a stimulus to industry to undertake the necessary adjustment measures, in order to be able to meet the challenge of world-wide competition. In other words, one benefit, or the most important benefit of the internal market, is to create a launching pad to prepare European companies for global markets more quickly. Global markets are, after all, the subject of our conference.

An EEC market protected by trade barriers would endanger all these chances. I would like to recall that trade policy is already the responsibility of the EEC, so we already do have a common trade policy, which, I would like to emphasise, is in general a liberal one. When we speak of the completion of the internal market, we mean that some remaining

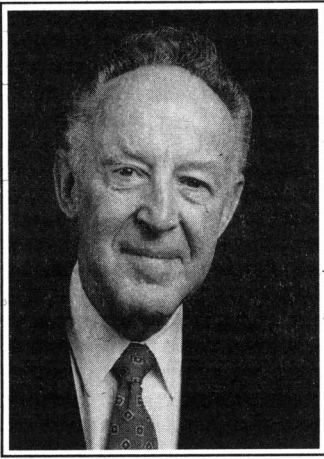
national import restrictions, held by some member countries, have to be abolished by the end of 1992. These national restrictions are only an exception to the common EEC trade policy. It can surely not be in the interest of a growth oriented European industry to replace these national import restrictions by community wide import barriers.

But I must admit, if complete deletion of trade restrictions is not yet possible for certain sensitive sectors, as they have been mentioned before, then the form of protection or restriction to be applied, should be the subject of careful examination. A restriction should not continue automatically, without any justification, or unaccompanied by restructuring measures. It would be possible to apply a kind of safe-guard similar to the already existing EEC import regulation, regulation 288 from 1982, with the proof of injury, and that would be a very important point to have this proof of injury.

Other conditions might be added: protection should be on a temporary basis, and be accompanied by a restructuring measure. I think the import regulation which I mentioned, is the right instrument to use. Consequently there is no need for further instruments in the EEC. Hence I am convinced that the EEC is already well equipped to face all the problems. Now I want to say a few words on reciprocity.

I accept reciprocity regarding framework conditions, e.g. in the banking sector, the banking directive issued recently by the community. Liberalisation in the EEC could be a negotiating lever to force other countries to open their market which helps to liberalise world markets in general. However, reciprocity should by no means involve a reciprocity in terms of trade or trade balance.

Finally, I agree that it is vital to have a powerful EEC, to defend its common interests, thus the EEC should use its credit in the Gatt negotiations, to fight against restrictions and to fight against grey area measures, or voluntary export restrains.



*William D Eberle*

President, Manchester  
Associates, Ltd.

CED

Time is short so let me try to give you a few comments in reaction to what we have heard, in a rather concise way. I hope you will not feel it is too blunt, or too trade negotiator, but it is from a view-point of a businessman and a politician. First of all, let me say that US political activity has, I think, accepted the multi-lateral system, as the way to go, and that is the objective. Both candidates for president are not protectionist. The new trade bill has nothing new in it that was not in the 74 act, it has certain nuances, but the president could do everything that he can do under this act that he could do under the 74 act. So I am encouraged about where the United States is going. I think that when we are talking about trade we are also talking about politics. The first two speakers I think give me great optimism, because failure of the Uruguay-round would be a disaster. Why? It is not a platitude to say the round must be successful. First of all, unless trade can grow through an improved multi-lateral system, Europe, Japan, the United States, and the third world, cannot adjust.

Secondly, as our first speaker said, unless we can have more world trade, and that means openness, the third world cannot pay its debts, cannot get growth, and will be unable to be a purchaser. Latin America reduced its imports from the United States alone, of 30 billion dollars a year, as it met the IMF requirements and balanced their own calculations. And the third area, which I think is equally important, is that of 1992. I love this openness, and believe this has got to be the way to go.

But it does not necessarily have to go that way. A failure in the Uruguay-round, or a turning inward in 1992, will create all the fears that some of you have had, about retaliation, bilateralism, and the movement of the United States to block trading, further to the Pacific, and away from the Atlantic community. Having said that, let me raise just a few questions of concern about 1992.

First of all, the concern that we would have in the United States is that if the European manufacturers positions, in moving toward 1992, and this is in writing, so it is not something that I am pulling out of the air, that they would like to see an 80 per cent minimum local content level, you can expect from the United States retaliation in very tough terms. That is a fact of life that we might as well accept. If there is an attempt to restrain automobile import from Japanese plants in America, the United States politically will retaliate. The United States business community, the political parties support a unified Europe. That support will remain there as long the community remains open. The United States business community has fought hard against local cartel laws. It has won that battle politically, and with the public. For another major trading nation to consider they will cause trouble in the US and they will demand reciprocal treatment.

Another point is the discussion matter the community as to reciprocal treatment. The EC commission has indicated it will examine sectors and companies on a case by case basis as to whether they are a community business. They will examine the nature of the plant, if R & D is done etc. Let me assure you, if that is the definition of national treatment and reciprocity, the United States is going to be in trouble, trade-wise, with Europe. I could give you as examples, like telecommunications, when the United States opened up its market to the world by breaking up AT & T business. No one ask reciprocity. We allowed everybody to come in and compete. But there are examples of the kind of concerns that our politicians and business people have. Another concern would be the failure of the Uruguay-round in the mid-term review in December, including agriculture. It is time that the world recognises there will be no success in the Uruguay-round on merchandise or services, or anything else, unless there is success in agriculture. That does not mean the US position but unless there is an openness in that market, services and merchandise trade will move backwards.

Now, having said all that, the positive side is we have the opportu-

ity. The positive side is that we can move forward with more open markets whether it be the US-Canadian agreements, in 1992, or the Uruguay round successful mid-term review, but the political will must be there around the world to carry it out. Yes, there will be a tough negotiation, but there has got to be understanding and commitment from the business community in my opinion, throughout the world, not to be requesting local content not to be requesting other kind of trade restrictions but to fight for more open markets. This increased trade can only mean growth, increased standard of living, third world adjustment. It is much to fight really.



*Björn Wahlström*  
Chairman, SSAB  
SNS

I am here to give you a simple businessman's view of the Swedish situation – there are so many clever politicians around and large organisations talking about the matter, so I am going to show you a few over-heads about a businessman's view of the Swedish situation.

Industry will have all the advantages; very simple, a more dynamic Europe, less national market, long series, specialisation comes very simple. We will have more efficient use of resources, better growth, and better prospects especially for small companies. The large companies will always take care of their interests. This means in general: better standard of living, higher wages, etc. What I have said now is subject non-discrimination.

## ADVANTAGES

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### 1. General

- More dynamic Europe
- Less national market segmentation = longer series of production

### 2. If non-discrimination

- More efficient use of resources
- Better growth for value added products including knowledge intensive
- Better prospects for small companies



Higher relative wages

If we take the disadvantages, we can see that structural adjustments will be intensified. We will have more international dependence, we can see that the disadvantage of smallness, will increase; scale, research and development, financial power will be more important and the disadvantages relative to the common market will be worse for Sweden.

We have some sectoral differences for the industry. If you look at the manufacturing industry, we have lots of gains from integration. The plant and company structure will be better. We are well internationalised. Sweden I think, has fairly good management. I dare say that of all the countries, the Swedish manufacturing industry is one of the best in the world. The plant is efficient, modern, first class. People are well trained and our raw material are first class. There is only one way to be competitive in the long run, and that is to be the best, to be the most cost efficient, have the best plants and a sound economy. Swedish industry is owned by Swedes, but it is already working mainly or to a large extent outside Sweden. If we are in a situation with a large common market, I believe that manufacturing industry, the large part of the

## DISADVANTAGES

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### 1. General

- Structural adjustment intensifies
- More international dependence

### 2. If discrimination

- Smallness disadvantages increase → scale, R & D, public purchasing etc.
- Distance disadvantages relativ to EG increase
- Risk and uncertainty larger in medium run

Swedish industry, is already in a very good position, and will not be so highly dependent on whatever is agreed upon.

For the service sector, on the other side the new market has mixed effects. Some are winning: the international and large service companies, the building industry, the banks, especially the large banks, some industrial consultants, knowledge intensive industry, and logistically complex sectors.

Finally agriculture is going to lose, by the simple fact that it is not competitive. It has been working in the political mud, so to say, for many, many years, dependent on political decisions, here as well as in other countries. And there is no hope, whatever decisions are taken.

Conclusions: If we look in the industrial side, I do not think there are really large problems. Swedish companies, will avoid the EEC discriminations. We will be a part of Europe, we need Europe, and Europe needs us. Of course there will be lots of negotiations, but that is another aspect. The small industrial companies, and large service, or agricultural, large agricultural producers, can lose or win, but probably there will be a lot of demand for reciprocity that makes it very hard for these companies.

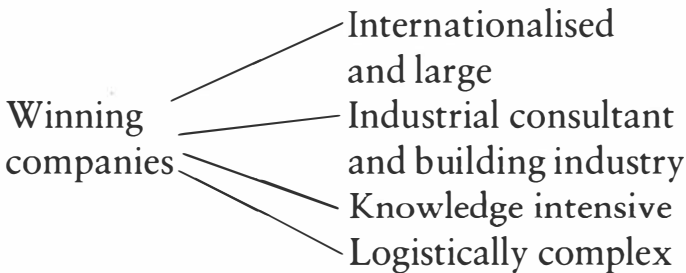
## SECTORAL DIFFERENCES

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### 1. Manufacturing industry gains from integration

- Plant and company structure
- Well internationalised
- Good management

### 2. Service sector → mixed effects



### 1. Agriculture loses

Knowledge – intensive or other high value products and functions may move out of Sweden if too much reciprocity, or too much discrimination, is put on Sweden. And that will lead to a lower standard of living, and a lower standard of work in Swedish companies.

## CONCLUSIONS

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- Big Swedish multinationals avoid EC discrimination in ways that makes our industrial nation a loser
- Small industrial companies *and* large service or agricultural producers lose if Sweden remains discriminated against
- Knowledge intensive and other high value-added products and functions move *if* discrimination or with remaining uncertainty

SESSION II  
Impacts of Internationalization  
on Labor Markets and Production

*Chairman: Gert Becker, CEPES*



# Getting ready for 1992

## *What Companies are Doing to Prepare for the Internal Market*



*Zygmunt J A Tyszkiewicz*  
Secretary-General, UNICE – Union  
of Industrial and Employer's  
Confederations of Europe, Brussels

Not so long ago, if you stopped someone at random in the street, anywhere in Europe, and asked: "1992: what does that mean for you?" You might have heard some reference to the Barcelona Olympics or to the 500th anniversary of the discovery of America. More likely, you would have got a puzzled stare.

If you had asked that same person to tell you the meaning of the word "internal" you would probably have received a correct reply. The same for the word "market". But if you asked the meaning of "Internal Market", the puzzled stare would probably have returned.

Now, three years since publication of Lord Cockfield's White Paper, there is remarkable (if patchy) growth in awareness of the Community's plan to create, by the end of 1992, a single internal market in which people, capital, goods and services will move freely across the international frontiers of the twelve. Strangely, awareness seems more sharply tuned in non-EC countries – notably within EFTA, in USA and Japan.

Mr Cor van der Klugt, President of Philips, said in Brussels last June:

”European executives are still sceptical about the opportunities after 1992, while in Tokyo and New York people are already talking about Europe 1992, the United States of Opportunities.”

Leo Tindemans, Belgium’s Foreign Minister went even further. He said: ”History will judge the Single European Act as the political event of greatest importance in European history since the French Revolution”.

## Stage I

It seems to me that there are clear stages on the way up the Internal Market learning-curve. In stage I, you find out the facts. This means actually reading Lord Cockfield’s White Paper. It means becoming familiar with the implications of the Single European Act. It also means monitoring, on a regular basis, the progress being made by the European law-makers in implementing Lord Cockfield’s programme of some 300 directives to be approved by the end of 1992. Until you find out the facts in this way – you cannot enter Stage II. Yet I am always amazed by the number of business-people who have still not read the White Paper, who have only a hazy idea of what the Single Act is about and who are not in regular touch with what is happening in Brussels, where decisions affecting our lives are being prepared with bewildering speed.

## Stage II

Stage II begins once you *are* well informed. You have the facts, but you must still be convinced. If you are on the inside, you have to convince yourself that creation of the European Internal Market is not just something desirable, but is essential and urgent to ensure Europe’s survival in a fast-changing and highly competitive world. You have to become aware of the appalling consequences for the EEC of failure to achieve the 1992 objectives. You have to appreciate the huge costs of ”non-Europe”. If you are on the outside, you have to convince yourself that the EC will in fact carry out its ambitious plan, otherwise, what need is there for you to act?

But, in this second stage, you should not be convinced only by fear of

the external threats. You should also be driven by an awareness of the tremendous opportunities for your business, if Europe learns to exploit the full potential of a home market of 320 million consumers.

## Stage III

Properly informed in Stage I, fully convinced in Stage II, Stage III is reached when companies begin to act. At this point, the problem is well on the way to being solved. The regulations and directives of the politicians begin to be translated into concrete actions by the entrepreneurs. The process gathers a self-sustaining momentum and from that point on, becomes irreversible.

You can find companies in the twelve member-states in all three stages. Without a doubt, France is ahead of the field, but by and large, most European companies are now in Stages I and II and many are on the verge of Stage III. They are beginning to ask themselves: what action must we take to prepare ourselves for 1992?

The aim of this talk is to stimulate thought and to suggest some, incomplete answers to that vast question. Every company is likely to find itself affected in some way as markets adjust to the free flow of goods and services, finance and people and above all to the removal of national frontiers. For some companies, these changes will pose an unwelcome threat as they face competition from new, possibly lower-cost suppliers. To the more dynamic, however, the internal market offers considerable, opportunity, since the rewards of efficiency will increase. These companies will have recognised the need to rethink their strategy to prepare themselves for 1992.

Companies Operating in EEC states whose GNP is less than 75 per cent of the Community average will also be eager to seize the opportunities, offered by the recently increased "Structural Funds", whose purpose is to help these countries modernise their productive apparatus and become more competitive.

Business leaders are rightly insisting that the private sector must play a greater part in the process of deciding how these funds should be used. The criterion is "additionality". This means the funds must be used to create something new, something additional for the economy.

What a tragic waste if these funds are used simply to finance normal national expenditures or, worse still, to keep alive industries which are

technically dead and beyond resurrection. If structural funds are misused in this way, by 1992 nothing will have changed – and these countries will not be ready to meet the challenge of an open market without frontiers.

For the purpose of this talk, I propose to assume that the internal market programme will have been more or less completed by the end of 1992. I assume therefore that frontier controls are dismantled, transport restrictions removed, standards are mutually recognized and in many cases harmonised, public procurement is open to Community-wide tendering, State-aids are abolished, qualifications mutually recognized and there is free movement of people, money, goods and services. Furthermore, despite the difficulties, appreciable progress has been made towards approximation of VAT and excise duties.

First and foremost, companies must make sure they are efficiently represented in Brussels.

This means they must strongly support not only their sectoral organization but above all, their national, central federation, both financially and through active participation in its work. In its turn, the national central federation keeps a highly qualified and competent Permanent Delegate – or "ambassador" in Brussels. It also adheres to UNICE, recognized by all the Community institutions as official spokesman for European business and industry. Through this network, companies can obtain much of the information they need.

More importantly, via the national federation and through UNICE, they can also influence the European lawmakers. It is important to understand that, as we move towards an Internal Market, so the decisions affecting business will, increasingly, be made in Brussels. Individual companies, especially the large ones may have felt less need, in the past, to maintain strong central federations, because they felt able to exercise direct influence on national governments. Now, the voice of business must be heard in Brussels. To be effective, this must be the single voice of UNICE and not a cacophony of individual, contradictory company voices from all corners of Europe. However, only strong institutions will be able to make themselves heard at this level.

Next, companies must consciously foster a radical change of attitudes among their managers and staff. They must begin to think of Europe as their back-yard and not as some foreign place to which one goes "abroad". When they talk of "exports" or "imports" they must no longer think of a movement of product from one Community coun-

try to another. Which US Company in California thinks it has "exported", when it sells goods in, say, Colorado?

In the fields of transport, public purchasing, energy, telecommunications, insurance, banking and many others, they must make a mental adjustment to the continental dimension. They must learn to "think European".

Managements must know what the EEC is all about, how it works and what it is doing and they must ensure that all the company's employees know these things as well. A senior manager must be made responsible for this activity.

Above all, management must stress the fact that 1992 is an opportunity, not a guarantee.

To quote the Spanish Commissioner, Abel Matutes: "Competitiveness is the only valid passport for travelling through the new lands of the large Internal Market."

This message must be heard and understood also by Trade Unions, whom managements must keep equally well informed.

While still on generalities, I want to stress the importance of languages. In a true Internal Market, the company which can operate in several languages will always have a commercial advantage. Even if you speak one of the "big" languages, this remains true. English speakers, for example, will always get-by outside Britain. But if they are trying to sell a product in Spain, in competition with Germans who speak Spanish, then I know who is going to win. Language is equally important for your labelling, your promotional literature, and the operating instructions for your product. It could also be crucial to your company's name and description.

Turning to more specific areas for action, companies need to re-think their strategy at a European level, based on an assessment of the implications of the Internal Market for:

- the geographic distribution of their operations,
- the coordination and control of their activities.

The Internal Market will allow and encourage companies to carry out their various activities – production, marketing and sales, servicing, R & D, procurement – at those locations which offer the greatest competitive advantages. Very fundamental questions need to be asked:

- Where to situate the head office?

- What corporate structures to adopt?
- How to re-arrange the capacity and supply-zone of each production unit?
- Where to purchase energy, raw materials, components?
- Where to carry out R & D?

The list is not exhaustive, but each of these basic questions needs a new answer in the context of a true Internal Market. Many companies are now studying these matters – often with the help of consultants (who themselves are re-grouping and re-organizing) and some are already taking action. I heard of one major brewer whose European network of breweries has been radically revised – involving closures and expansions – in anticipation of 1992.

Companies must also widen their market research, to study the needs and tastes of consumers throughout the Community. Even if they do not do this, they can be sure others will be doing it with the inevitable result that competition will increase. This will lead to further industrial restructuring. The companies that manage the process of adjustment most skilfully and imaginatively will be best equipped to succeed in the more competitive European market that will result.

One example quoted to me recently concerns a road transport firm which, anticipating hotter competition once the market is liberalised, has improved the range of services it offers to its customers. This Company is now in a position not simply to transport your goods. It can also offer to pack them at point of departure, then unpack and install them at final destination.

Incidentally, it is expected that the Internal Market will have this sort of effect in many sectors. As a result, consumers will benefit and new jobs will be created.

In the area of human resource management, companies will need to review recruitment and training policies. The objective, clearly, must be to build-up a flexible organisation, capable of operating continentally. Greater attention will certainly need to be paid to language skills, to knowledge of EEC rules and institutions and to the ability to deal with people of different cultures and tastes. With the advent of mutual recognition of diplomas, new ways may need to be found to retain skilled local professionals. On the other hand, when recruiting, it will be possible to look for good candidates beyond the national labour market.

Personnel managers will need to follow very carefully all EEC legisla-

tion stemming from Article 118A of the Single European Act, which mainly concerns health and safety in the workplace.

They will need to continue monitoring developments in the area of industrial democracy and co-determination, for which there is strong Union pressure in Brussels.

They will need to anticipate Union attitudes towards Europe and to understand the implications of their demand for creation of the so-called "European Social Space". Business must be ready to respond to the development of pan-European union activity.

As mentioned earlier, thought will have to be given to corporate structure and finance. The competitive situation in an Internal Market may lead companies to consider new alliances through joint ventures, acquisitions or mergers. From mid-1989, the European Economic Interest Grouping (EEIG) – a new form of joint venture – will come into effect as a legal framework for cooperation on specific projects between at least two companies based in different member States. This will be the first example of a corporate body constituted under EEC, as opposed to national law. Other forms of European corporate structure may also emerge from legislation currently in the pipeline, provided the "industrial democracy" provisions included in the drafts are seriously watered-down or dropped altogether.

With the liberalization of capital markets, companies will be free to raise finance in any EEC market, and of course, from Community instruments such as the EIB. They will be able to shop around for the best terms as regards loans, mortgages and insurance cover, and therefore, to prepare themselves for this new situation.

Opening-up of public procurement and public works contracts to Community-wide tendering will create new competitive threats for some companies but attractive opportunities for others. Companies must organise themselves so as to be aware of calls for tenders in all member-states, including in the presently still excluded sectors of energy, water, transport and telecommunications, which by 1992 will be freed.

The breaking-down of non-tariff barriers, the abolition of State-aids and subsidies and the liberalisation of markets will cause certain industrial sectors to re-structure and re-group themselves. This is particularly true of the heavy capital equipment sector, for instance steam turbines for power generation. Where Europe now has 8 to 10 independent manufacturers, there may be room for only two or three. The

question will be how to achieve this re-structuring with the minimum pain and disruption.

Similarly, raw-material and energy procurement sources could change, causing a major shake-up in many sectors. Such changes must be anticipated and planned.

Small and medium enterprises must be aware of all the special schemes, organisations and EEC instruments which already exist – or are being set-up – in order to help them profit from the opportunities opened up by the Internal Market.

The Commission's special Task Force on SME's headed by Alan Mayhew under the political direction of Commissioner Abel Matutes, has created an atmosphere of dynamic initiative, words rarely used to describe a bureaucracy. A Community Action Programme for SME's was drawn-up and approved by the Council of Ministers in October, 1986.

Information will be available through the "Euroguichet", or Community Information and Service Centres, of which about 40 already operate as a pilot project and 250 or more will be operating by 1989.

Help in contactors will be provided by "BC-Net" – the Business Cooperation Network – which will help link up cooperation offers and requests between firms on an inter-regional and trans-border scale. The network will offer companies the means quickly to find a financial, trade or technical partner.

The ICONE system supplies information on the compatibility of national standards.

The NCI – or New Community Instrument – provides funds for loans to SME's, especially for new-technology projects in the poorer regions of the Community.

The Venture Consort Project is a pilot scheme between the EEC and the European Venture Capital Association. It concentrates on bringing together specialized investors from several member-states and providing them with Community aid for newly created SME's operating in modern technology sectors stretching across national borders.

The European Social Fund can provide money to finance SME training.

People quite often claim that the Internal Market will benefit only the multinationals, and the SME's will suffer.

I disagree. Multinationals are already present in all EEC markets. The removal of barriers will lower their costs, but it will not directly

increase their turnover. SME's on the other hand need no longer hesitate to expand into the next-door member-states, since obstacles such as the need for repeat-testing and re-certification or the obtaining of special permits will have been removed. They will benefit from schemes and aids such as I have mentioned and furthermore, subject to a system of thresholds, they will be exempt from certain rules of competition and from compliance with various other EEC regulations.

SME's can thus create a "grass-roots Europe", emerging from below rather than imposed from above. The opportunities open to them are endless and exciting.

Finally, a brief word about non-EEC companies: those from EFTA, from Japan, from the USA and elsewhere who are interested in the EC Internal Market.

The main question they are asking is: will the post-1992 Internal Market develop into a "Fortress Europe", making it more difficult for non-EC goods, services, capital and people to enter and circulate?

Fuelling such fears are the repeated calls, by certain sectors of EEC industry to the Commission, to make use of Europe's greater leverage – once it becomes a single market – to insist on reciprocity in trade relations with third countries.

This subject – particularly as concerns EC/EFTA relations – deserves a separate talk. My only purpose, today, is to mention it as one vital issue, which the representatives of industry from within and without the EEC must help the politicians to resolve in the best interests of the "Global Market" to which we all belong.

## Summary

I have mentioned:

- proper representation in Brussels, and support for your national federation of business and industry
- the need to change attitudes
- the importance of languages
- the need to re-think strategy, so you do things where there is competitive advantage
- the need to ensure proper use is made of structural funds
- the need to widen market-research

- the implications for human resource management and industrial relations
- the alternatives as regards corporate structure, new alliances and finance
- the opportunities in public procurement
- the likelihood of industrial re-structuring
- the special position of SME's
- the implications for external trade.

I could have evoked many other subjects for instance: technical standards, services, transport, removal of subsidies, abolition of national quotas on third country imports and so on, which all need attention.

Creation of the Internal Market has not just moved the goal posts. It has shifted the whole ball-park. It would not be possible to cover all the resulting changes in the space of one short talk.

Lord Cockfield once said:

"A free enterprise system works effectively only if it is both free and enterprising. We, the Commission, are trying to put the "FREE" into the phrase. It is up to Europe's companies to put-in the "ENTERPRISING"."

Industrial leaders throughout the European Community know that companies *must* prepare themselves to take advantage of the commercial benefits which the removal of national barriers and the completion of the Internal Market will bring. They know that companies will also have to meet the commercial challenges, including increased competition, and they know that preparation will involve a systematic review of every area of a company's organisation and activity.

They may be less certain *when* this complex, demanding review should begin. Doubts whether the internal market will be completed as planned may tempt them to postpone the decision.

This would be a grave mistake. Commitment to removal of non-tariff barriers is now very strong, both among politicians, business leaders and trade unions. If the 1992 deadline slips by six months or a year, that would be irrelevant to the points at issue.

Companies that do not take action now must realise that others have already begun. If they miss the boat, they will have only themselves to blame.

It was Jean Monnet who said:

"Haste helps those who know where they are going."

Let us all make haste so we are sure to catch the boat in 1992.



*Count Gustaf Douglas, Vice Chairman of SNS, in conversation with the Lord Roll of Ipsden, S.G. Warburg Group, Chairman of PSI. In the background Mr Takashi Ishihara, Chairman Nissan Motor Co Ltd, and Chairman of Keizai Doyukai, Board of Trustees.*

*Dr Carl-Johan Åberg, Under Secretary of State, with Mr Takashi Ishihara during lunch hosted by the Swedish Government.*





*Professor Isaiah Frank of John Hopkins University, Baltimore and CED was the first speaker at the Conference. Here with Prof Göran Ohlin, ass. Secretary General at the United Nations, New York, and former board member of SNS.*

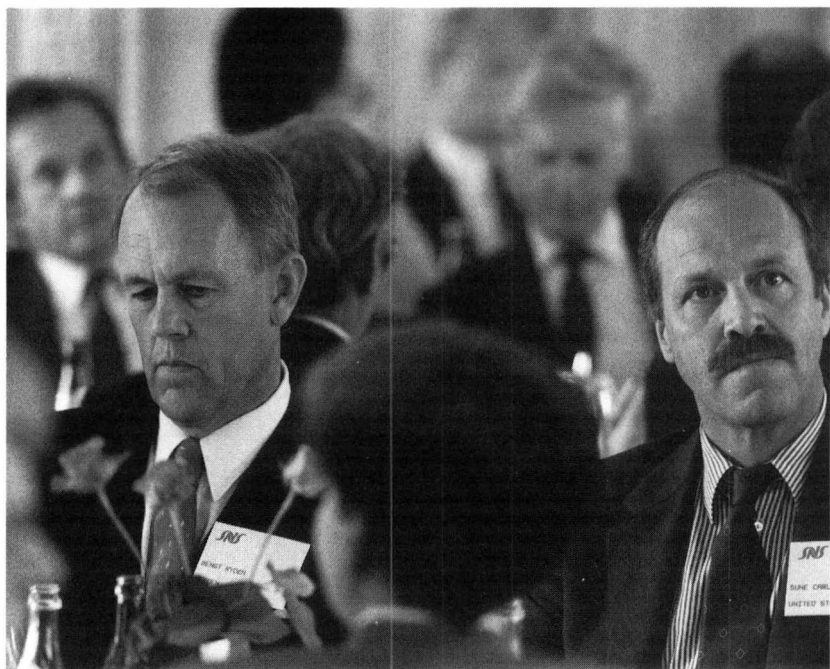


*Members of CED delegation, William J Beeman and Mr Owen B. Butler, new Chairman of CED Board of Trustees.*

*Dr Carl-Johan Åberg, Under Secretary of State, addressing guests at lunch hosted by the Swedish Government.*

*Prof Isaiah Frank and Dr Hans Tson Söderström, Executive Director of SNS, at lunch. In the background Ambassador Henri Froment-Meurice, IDEP, and Björn Wahlström, Chairman SSAB, SNS.*





*Dr Bengt Rydén, President, Stockholm Stock Exchange and former Executive Director of SNS with Sune Carlsson, Vice President and Controller, World Bank, Washington D.C.*

*Mr Owen B. Butler, Chairman, CED Board of Trustees with Baron Stig Ramel, President of the Nobel Foundation, SNS.*



*First speaker at Session II was Mr Zygmunt Tyszkiewicz, Secretary General, UNICE, Brussels, on 'Getting ready for 1992'.*

*Comments were delivered by int. al:s Mr Carlos Espinosa de los Monteros, CE and Dr Gert Becker, President and CEO, Degussa AG and Chairman of the CEPES Board of Trustees.*





*Mr Percy Barnevik, President and CEO, ABB, Zurich, and member of the SNS Board of Trustees, presented world market strategies for companies like Sandvik and ABB.*

*Mr Barnevik was followed in the rostrum by Dr John Nieuwenhuysen of CEDA, one of the hosts of the Australian meeting in May of 1989.*

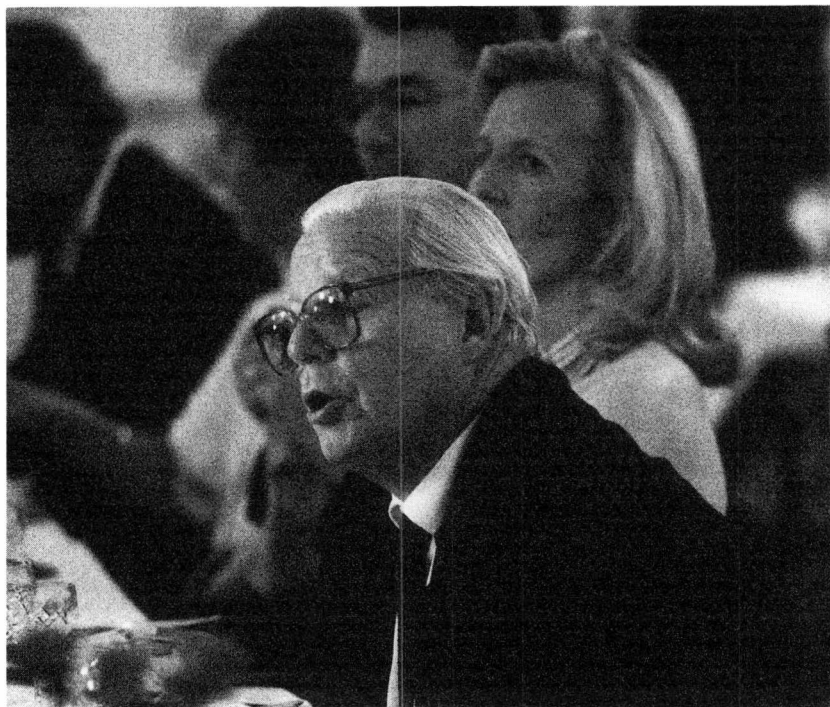




*In the panel of Session II were Mr Nabuo Tateishi of Keizai Doyukai, and Mr Dean Phypers of CED.*

*In center of picture Dr Gert Becker, who was chairing the Session.*



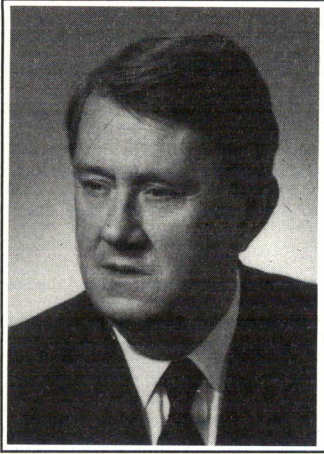


*On August 30 delegates were entertained to dinner by the Federation of Swedish Industries. The dinner host, Dr Peter Wallenberg with lady Caroline Ure, wife of the British Ambassador to Sweden.*



*Margaretha Jonth-Lyttkens and Håkan Sund charmed the audience with song and music.*

# Comments by a panel of Trustees



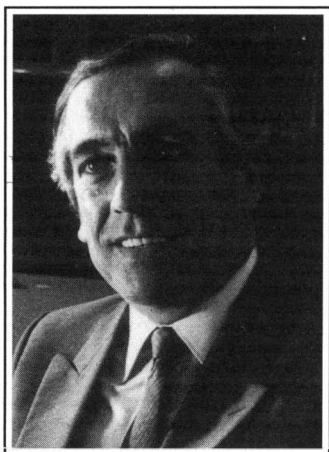
*Vsevolod Dmitrieff*

President Construction Industrielles  
de Méditerranée  
IDEP

What has been said corresponds to large-scale business organisation, and probably the view of the general public. I think it is perhaps interesting to find out what is going to happen in this maelstrom, to a medium size firm in the high technology, capital goods sector. As far as my firm is concerned, 1992 is already here, because the French economy is, contrary to what is often said, extremely open to the international market. The issue, for us, is to know whether 1992 will favour an expansion in other countries of the community. In fact, our experience presents widely contrasting situations dependent on the product concerned. As regards arms, we build the missile launcher for the French submarines. This is clearly not a standard line of business in international trade. We have another military product, a floating bridge for the engineer corps of the French army.

Here the trade barrier is quite different, because France is outside the integrated Nato command, and the arms industry of the European community has not yet come into existence. We are also involved in the nuclear area, which in Europe is a purely national activity with the expectation of a few projects which have been completed. We also build boilers for industry. Here the obstacle is different, namely the long distance transport of exceptionally long pieces of machinery which makes the market a local phenomena. We also produce urban

waste in generator plants. These remains, in conclusion, one product line, escalators, which can be considered a standard commercial item. For the Europe of the common market, a distinction must be made between manufacturing countries, mainly West Germany and France. We are involved in all the common market countries except West Germany. We are hoping that 1992 will provide us with access to the local authorities in that country. Meanwhile we are preparing by completing the formalities required to conform to the German standard. I hope I have not bothered you all too much by talking about my micro-economic problems.



*Carlos Espinosa de  
los Monteros CEO*  
Mercedes Benz Espana  
CE

I will try to make some comments on the presentation of Mr Tyszkiewicz, as well as on some parts of the automotive sector. I am not an expert on the automotive sector, but I would like to raise a number of points.

Firstly, regarding the paper presented by Mr Tyszkiewicz. In my view, the businessman's attitude today in Europe, is mainly an attitude of optimism. Everybody thinks that from January 1st, 1993, there will be a lot of opportunities; a lot of opportunities to sell more, since we will have a much larger market of 320 million consumers. If we do it well, if we do our homework in each of our companies, we will be able to sell more, and we will have an opportunity to reduce our costs. As I

see it, everybody in Europe today, at phase 1, phase 2 or phase 3 of what he has defined, is working hard with the prospects of considerable opportunities coming from a much stronger and larger single market in Europe.

As many of you may know, the Cecchini Report which was requested by the European Commission and just released three months ago, tried to evaluate the effects of this single market in Europe, if it was implemented January 1st 1988. The result of that report was that the advantage for the whole European economy would be equivalent to 5 per cent of GNP in Europe. This single market should be compared with the situation that we have today with substantial barriers, limitations and obstacles of all kinds. We are in favour of going ahead, of taking the challenge, of organising to be prepared for January 1st 1993.

However, there are several areas of concern. One of the areas which has been raised by the paper is the question of what the unions are going to do. How are the unions going to behave, once we have a single market in Europe. The unions today, I think, are much more reluctant to confront the single European market than most managers of businessmen. If you look to what is happening in, what the Herald Tribune called "the merger mania in Europe", one sees that behind each of these merger in Europe, there is some kind of opposition from the unions. It is very rare that the unions give their approval to a merger of two large European companies.

However, we do have to protect the jobs affected by the mergers. We would not wish to see a merged company which at the end lost jobs. As you know the main problem in Europe today is unemployment. There are over 20 million people unemployed, and there is not much hope of creating new jobs in the next 4 or 5 years. This will be, of course, a highly significant problem for the unions. They are naturally concerned that decisions will be taken at a greater distance in a single European market and that as a result they will lose bargaining power and influence. Another interesting European example was provided last spring by the case of the Ford Motor Company in Europe, where because of a strike in one country, all other factories in Europe expressed their solidarity and interrupted work in Belgium, Germany, England and Spain. That was really the first case of pan-European union pressure applied to an American multi-national company which has factories in all these countries. I think that this is something that we will start to see increasingly often, since unions of different countries are getting

together attending meetings similar to this one, but held instead for union leaders in different countries in Europe. We may also see that with the coming of the single market, there would be a desire on the part of the unions to try to harmonise policies in terms of wages, working hours, fringe benefits and other issues related to the wellbeing of workers.

This, naturally, is going to be a substantial change, and in the 90s, we will be living in a society in which the model which has been in force almost without change since the end of World War II, would in my opinion become quite different. I can foresee that negotiations will be increasingly conducted internationally across borders rather than at the national level.

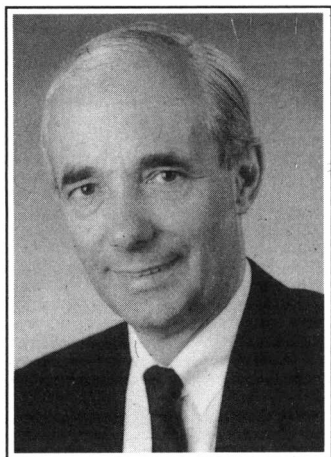
Finally, I would like to make some brief comments on the automotive industry. In my opinion, the automotive industry has been a front runner of the concept of the "one global market" concept. In the 60s and in the 70s, we have seen most of the European and American companies going beyond the borders, setting up factories, or assembly plants, in other countries in Europe, America, Africa and Asia. More recently we have started to see some Japanese firms moving out of Japan and opening factories in the United States, various countries in Europe as well as in some under-developed countries in Asia, such as South Korea. This has been a fairly normal pattern in the automotive industry. There has been an increasing tendency, not only in terms of production, but also in terms of marketing for automotive companies to look for sources beyond the national borders in order to find the most efficient manufacturer of parts and components. At the same time, mergers among automotive companies have reduced the number of vehicle manufacturers all over the world.

And at the same time, some of these companies have cooperated in the development of joint programmes for manufacturing parts, components, engines etc. These are then incorporated in the products of different companies. This is the positive side of the automotive sector, in terms of being international, of playing the game of one global market. However, there are also some negative aspects, which the automotive sector will have to change in the near future. For instance there are still quotas, various restrictions, many regulations which act to limit entry into different markets. There is still a reluctance on the part of the unions to see factories opened in third world countries where the man power costs are lower. For instance the union representatives on the

boards of German companies will always resist attempts to transfer employment from Germany to third world countries where it can be carried out at a lower price. Hence there are still many things which will have to be changed to really reach the concept of one global market.

I would like to end by saying that I remember some 25 years ago, when I was attending a business school in the United States, a professor told me, if you ever are lost in a country, in the middle of a traffic jam, look around and if you are surrounded by Fiats and Alfa Romeos, you are not too far from Milano, and if you are surrounded by Peugeotts or Renaults, you are not too far from Paris, and if you are surrounded by Volkswagen, Mercedes and Opel, you are undoubtedly in Germany.

Well, this is still true in some ways, although there is one little difference. If today you are surrounded by Nissan, Toyota, Mitsubishi, you are not necessarily in Tokyo, you can be anywhere else.



*Dr Peter Frerk*

Member, Board of Managing  
Directors, Volkswagenwerk AG  
CEPES

I would like to add that if 1992 is a revolution, it is a silent revolution, because we expect no big bang. A Golf bought in Cologne comes from Belgium, a Polo bought in Austria comes from Spain. If a company has set up its European manufacturing pattern in the past years, there is no change, everything is set. Most competitors have established their manufacturing bases in Europe. There will be no shifts. There will be additional developments for Europe in 1993 in critical fields and adjustments will have to be made. For Volkswagen this happens in the financial services sector, where for example, we are one of the first European anti-trust merger cases, bringing InterRent and Eurocard together. This will be managed soon. Our company has no experience in aviation companies so we are not in the role of GM, Chrysler and Ford.

I would like to comment on some of the other presentations here. Regarding EC 1992 organisation in the company must be made at the top level. We have a permanent European 92 Team, which I chair, it deals with two main tasks: Future Marketing models and EC regulation scenarios of the future with their impact on our operations. This makes it essential that research and development, the legal people, the marketing people, and the economists are the main part of this task force. I think there will be no surprises, because in the technical field, believe it or not, the auto industry in Europe has already been deregulated. For example, the technical requirements and emission rules, to be laid down in 44 EC rules, have been completed in 42 cases. The remaining rules are also ready. They refer to glass, tyres, and regulations on

measures and weights and all will be ready until end of 1992, thus enabling the industry to have a European type approval scheme from 1993 on. These 3 singular regulations have been left open because some European countries want first to know what happens after tyres, glass, and weight have also been regulated.

In future marketing, the tax models will play a key role in the future European assessment. This means that the national percentage rates of added value tax will be adjusted, leaving only a 6 per cent difference between the countries. Although this vat-tax will be harmonised, some other relevant taxes will not be harmonised immediately, e.g. special taxes on luxury cars or registration taxes.

For this reason, our marketing division will have to expect some fairly grey market situations. The market areas situated along the European open frontiers between the EC countries will provide some new chances and opportunities, but also new risks for the dealer organisation. A company can handle this to a certain extent by some new means of coordination between the various dealer organisations in the different countries, but we all will have to face new experiences and our ability to adapt our sales strategies will be challenged. But if we combine all these future developments we are sure that all this will create more market opportunities, not less. So the chances will out weigh the risks of Europe after 1992.

A main item of European policies will be a concept to handle the future relations with other countries. I think I can only underline what M Eberle said this morning. Businessmen should try to avoid any retaliation in trade disputes. There is a simple phrase which I learnt in earlier years from GM. "Never join the protectionistic party, because exporting companies are much too vulnerable." So I think it is reasonable to take a position that stresses that the EC should not forget their vulnerable trade relations with the United States, and of course, with the EFTA countries within the framework of GATT.

Another major item will be our future trade relations with Japan. There are two views. In some countries of Europe there is a belief within the family of EC nations, that some protectionism called "integrated organisation" should be maintained. The other part of Europe, of which Germany is a part, believes that competition might lead to better results than protectionistic models. The future European sales policy frame to be established in Brussels will be influenced by perhaps 4 models. A completely protectionist sealing on Japanese car imports

imposed by the EC Community would seem entirely politically unrealistic. The fixing of who gets what, say Japan 10 or 15 per cent market share, would also seem to be unrealistic. At least it would not be good for competition, although some politicians in France, Italy and Spain believe in this approach.

A realistic view would have to include the future role of the imports by American transplants, and this means an increase of Japanese representation in Europe. This direction, seems to offer the most likely future model of European car import policy, as far as they are reflected in future trade rules coming from Brussels. They will include more imports from Japan into southern EC countries.

Let me add some words on purchasing and supply, which are to become more important. In the future there will be a shift beyond the European community borders. Discouraging could mean resourcing in the United States, and in the Pacific brim countries, including hopefully Australia. This is not a development limited to Europe.

Finally, personnel matters and industrial relations should be mentioned. Let me add, we have heard a lot here today about the union influence on the board. In Germany, co-determination was introduced in 1952 with 1/3 representation of workers on the board. In 1977 it became 50 per cent representation. Believe it or not, we still live and it works very well. But it is a major problem or a large headache to other countries. I would like to formulate a theory: There will be no significant changes in national legislations because labour questions are nationally based power compromises. The national scheme of relations between employers and unions cannot be easily transferred within the European community, but there will be a future increase of social dimensions in the EC policy after 1992.

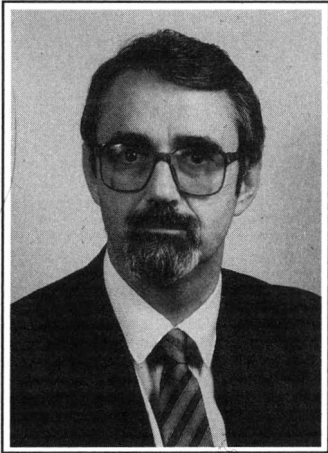
Personnel policy also includes the fluctuation and rotation of management within the group from other countries. In our company, we consider that it might be advisable, to follow the example at Volkswagen United States: This company at present is lead by a South African CEO who is assisted by a deputy who is a Scot and another deputy who is German. What a wonderful country that with a tolerant green card policy allows such a management policy and provides a wonderful opportunity for a company to develop international group personnel policies and international spirit.

Regarding information systems exchange, I do not think that there will be any problems in Europe after 1992. The legal side will face

adjustments. Not just for the French to follow German standards, but maybe for the Germans to reduce some top standards, because there will be competition regarding rules and regulatory systems between the EC partners. I think that in some aspects Germany has a somewhat leading standard, i.e. in anti-trust legislation, in environment protection. This could in the EC in the future be confronted by competition from other countries with less stringent rules, which in principle is not bad for a preparation for the future European market because this creates also new chances.

Let me end with a remark that was made by Mr Eberle this morning when he said that the business community should always stress free trade, and should be well advised not to request for protectionism. I would also like to underline that not every company needs a Brussels office for lobbying. We do not have one and we will not have one there in the near future. Our industrial associations are providing enough and fully satisfying service.

# World Market Strategies for Multi National and Multi Domestic Industries



*Percy Barnevik*  
President and CEO,  
ABB Asea Brown Boveri Ltd.  
SNS

One global market is the optimistic theme of this conference. As a small country, Sweden has, of course, since centuries, had a high dependence on trade with other markets, and that has characterized the structure of Swedish industry.

I will start with some comments on world market strategy for products where there is a reasonable free trade, e.g. consumer goods. I will then talk about strategy for infra-structure industries, e.g. public telecommunications, electric power and railways, which I happen to work with. Then, I will – on a case by case basis – discuss the Nordic countries as one market, and make some comments on the European countries as one market, before and after 1992. I will also comment on the developing countries, which have enormous needs, but lack equipment and financial resources. Finally, I will say a few words about global alliances between the big trading blocks.

## Sandvik's Niche Strategy

There is a classical pattern of development of successful Swedish companies: Specialize, move towards higher technology, establish direct selling units, then manufacturing units outside Sweden, go for world-wide dominance.

Few companies have pursued these themes harder than Sandvik, a speciality steel and cement carbide company, with 2 1/2 billion dollar sales and 25,000 employees. I have chosen this example since I worked there for 10 years, and I have been chairman for the last 5 years. The niche policy has been the main theme of Sandvik's history. The company was formed 125 years ago, and started from the outset with specialization. By the turn of the century, it had its own subsidiaries abroad. Today, Sandvik's president, Per-Olof Eriksson can be happy to see that he has some 50–60 per cent of his total invoicing in niches where he is a world leader – in some cases two, three times larger than the number two. A further 20–30 per cent of Sandvik's production places it as a leader in Europe. Sandvik, then, is an example of a very high degree of niche strategy, which is of course a cornerstone for good profitability.

In the 60s and 70s Sandvik embarked on a major internationalization in its manufacturing activities. The company now has some 100 subsidiaries in 40 countries, some of them major manufacturing units (including a couple in developing countries). Of its 25,000 employees some 60 per cent are working abroad today. 90–95 per cent of the company's total sales is outside Sweden. There are a number of reasons for the company's internationalization.

First, the need to be close to the customer. In the case of chain saws produced in Singapore, the main factor has been labor costs. Protectionism has also been a factor. Sandvik finally went the same way as SKF, the ball-bearing company, in terms of a far-reaching division of labor between countries for standard products. We produced one thing in one country and another thing in another country in order to obtain gains from specialization.

Interestingly enough, Sandvik in the 80's has to some extent moved back again to central production units, since developments in telecommunications, computers, air freight, etc. have made direct distribution possible. Something like two thirds of our customers in Europe can today obtain supply of standard cutting tools within 24 hours, from

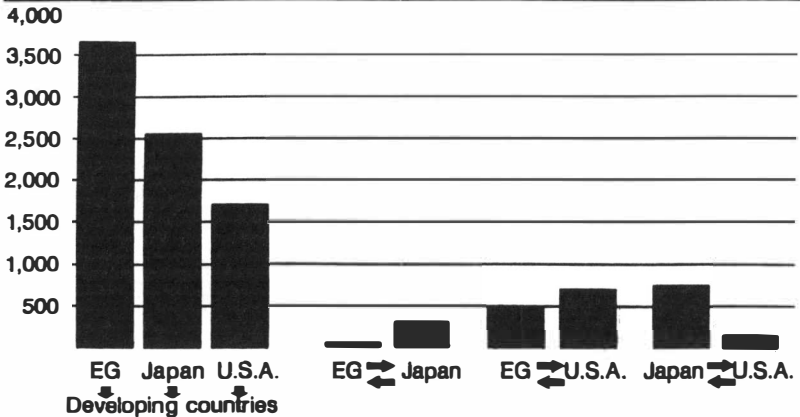
# Sandvik's internationalization during the 1960s and 1970s

1. 100 companies in 40 countries
2. Substantial manufacturing in all the major industrialized countries
  - U.S.A
  - France
  - Canada
  - Japan
  - Italy
  - Australia
  - West Germany
  - UK
  - Spain
3. Dominates the market in three large developing countries
  - India
  - Brazil
  - Mexico

Outside Sweden  
 60% of all employees  
 90-95% of sales

## Exports of electrical machinery and apparatus

USD, millions



one location. This is something that was unbelievable 15–20 years ago. In a further 24 hours we can cover a large part of our remaining customers. This is an extreme case of acting in one global market. The logistics of such operations are also extreme. Inventories have been reduced from 60–70 per cent of sales to 20–25 per cent.

That was what I had to say about market strategy for products with reasonably free trade.

## The Multi-Domestic Strategy for Infrastructure Industry

Infra-structure industry is, as I mentioned, another ball game. It can not be multinational, since it is highly fragmented and protected.

When you look at trade in electrical machinery you find a considerable flow of trade from EC countries, Japan and the United States to developing countries. However, trade between EC and Japan, between EC and the United States and between Japan and the United States, is almost non-existent. Even within the EC itself trade is very small. You produce and consume in the same country.

If we take a look at the European scene, we find a crowded electrotechnical industry with 20 large or medium-sized national companies. Many of them have up to 50 per cent over-capacity. National protection is widespread. Some companies are government owned, some government subsidized. We have in many cases outright exclusion of foreigners; they are not even allowed to participate in bidding. And there is a lot of hidden protection behind this visible protectionism.

In spite of high prices, profitability is generally poor in the industry. This is of course because you have a high cost structure: the restructuring process in the 80s has been very slow. These companies do not die, they live on almost forever. You look at them and you say: "In 5 years these companies will be gone". But 5 years later they are still around – not doing very well, but they are still around.

Compare this European situation with e.g. Japan where you have 3–4 large companies! (There are a lot of small specialized companies as well, but let us compare similar categories.) In the USA there are also some specialized companies, but in our category there are two important companies: General Electric and Westinghouse.

In the White Book, produced by the EC Commission recently, it is estimated that in turbine generators, where capacity utilization in Europe is 60 per cent, unit costs would fall by 12 per cent if borders were opened up. This is of course a highly theoretical calculation. However, it does give us some idea of the extent of the possible cost savings. The estimate is if anything on the low side. For locomotives, where capacity utilization is also low, a 13 per cent cost reduction could be achieved. There are 16 companies making locomotives in Europe. There are two in the United States, three in Japan.

How do you develop a strategy in that type of market? Since I came to Asea in 1980 our total sales had increased from 2 to 9 billion dollars, with an increase from 1 to 6 billion dollars in external sales. How was that possible with all this protectionism?

First, we followed Sandvik's example and focused on niches for tradable products such as robots. This was not a major part of Asea, but, as you know, it went from almost nothing up to a world leadership position in that particular niche.

Within the power sector, on the other hand, we encountered some of this slow growth. In these mature areas, you may be able to find niches where you could obtain a 20 or 30 per cent world market share. However, over a large part of the market you are not able to sell at all. The UK has not imported a transformer in 40 years. Not one.

Can you imagine the French buying a German nuclear power plant, or the Germans buying a French high speed train? It is almost inconceivable. Hence if you want to grow with that type of product, you must be an insider. We tried therefore to establish what we call the Nordic home market, where we could deal with these products across borders. For example, you cannot manufacture a high voltage DC transformer in Finland. If a deal is arrived at, involving an export order from Finland to a third country, this can now be arranged by supplying first the transformer from Sweden to Finland.

In Western Europe, North America, Australia and Japan it is necessary to have local manufacturing. Setting up our own plants was not particularly attractive, since there was already overcapacity in most of the industry. The solution was to buy companies. We have bought almost a hundred companies in the last 8 years. Capacity is purchased and then restructured and upgraded in order to improve manufacturing performance. In developing countries it was the same story.

# The Nordic Home Market

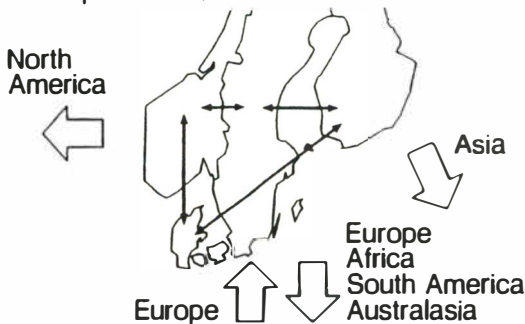
Why was it so important to create, not a global, but a Nordic market? After all, we are 23 million people in the Nordic countries, and demand for electrical products is about the same as in the UK, 2/3 of the demand in France and almost half of the demand in Germany. Hence it is a fairly large market taken together. Our strategy was to specialize in different countries. Small motors were manufactured in Denmark, automation equipment for the offshore industry was produced in Norway, etc. Different countries were given different supply roles in the overall set-up.

There is also another interesting aspect of the Nordic countries, namely the infrastructure between countries, i.e. the gas net-work and the power grid. We had a vision of a Nordic power pool, with AC/DC links in all directions, over to the Soviet Union, down to the Continent, between Norway-Sweden, under water, over water, etc. Everything

## ABB in the Nordic region

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- Important home market - 65,000 employees  
(Sweden: 35,000, Norway: 15,000, Finland: 10,000, Denmark: 5,000).
- Largest "Nordic company" - Annual turnover US\$ 8.5 billion, of which exports US\$ 3.4 billion



would be tied together in a Nordic pool.<sup>1</sup> In terms of resource allocation this is highly efficient. Of course, a lot of equipment, particularly transmission equipment, will be required here. To have local production in the different countries is a great advantage when trying to set up and combine projects. In the Nordic region we therefore aimed at expanding into our neighbouring countries in 1980.

We only had 14,000 people employed in neighbouring countries prior to the merger. Following this merger and some additional acquisitions the figure became 30,000 there, 35,000 in Sweden. And now one can see a Nordic region, i.e. one self-contained market, where intra-nordic trade is growing very rapidly.<sup>2</sup> Within our own group, it is probably growing at present by 10–25 per cent per annum between Norway, Sweden, Finland and to some extent Denmark. You can see us as a large Nordic company with a turnover of about 8 1/2 billion dollars, of which exports account for around 40 per cent. The principal export markets are North America, Asia, the Southern Hemisphere and Europe.

## The ASEA-BBC merger

As I said before, Asea did not succeed in penetrating Europe, because we were unable to export in a number of major product areas. There was only one solution, and that was to buy companies. On the one hand, there was BBC, this major arch-rival for a period of over a hundred years, in Italy, Switzerland, Germany, Austria and other parts of the Continent. On the other hand, there was Asea in the Nordic countries. By combining the two into one company, it was possible for both of us to gain overnight a huge foothold in Europe, both inside and outside the Common Market.

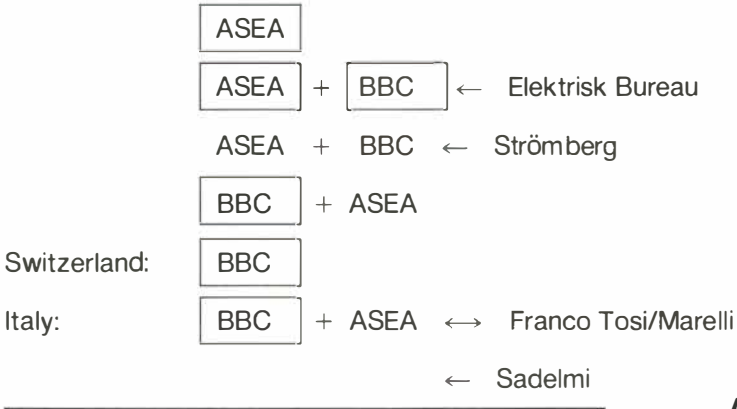
We then added Norwegian, Finnish and a couple of Italian compa-

<sup>1</sup> Of course, you have a similar process taking place in Europe, which is increasingly being tied together in infra-structure, gas pipe lines, high speed trains, rail net-works, under the channel etc. It is consequently a great advantage to be present in these different countries.

<sup>2</sup> Of course, Finland has its special situation and Denmark is a member of the Common Market. Hence we do not really have a free trade region per se, but we must try as well as we can, given the existing barriers and opportunities. We try to behave as if it were one Nordic free market.

# A Federation of National Electro-Technical Companies in Europe

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**ABB**

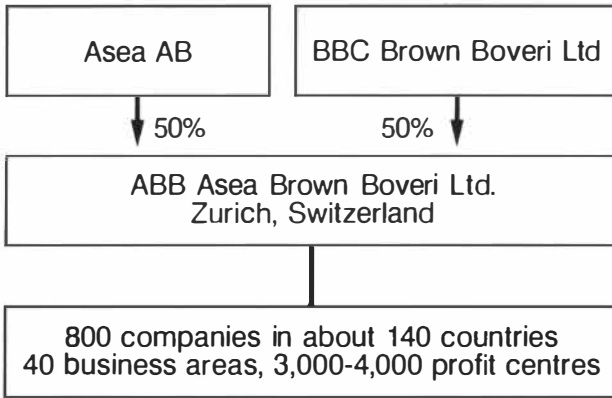
nies to the merger. It was not really a two-company merger, it was a multi-company merger. The structure that we obtained then was what we called European based, European owned, and European managed. That was important, because a lot of the constraints, were of a psychological, nationalist nature. It was very difficult for the former Asea, a Swedish company, to move into Norway and obtain a majority holding in the national Norwegian electrotechnical industry. But if we could say to the Norwegians: "Why don't you join the European federation of national companies, and participate as one member in this group", that was a different matter.

The two main partners are now on six stock exchanges, and six major subsidiaries are listed themselves with minorities in their countries. In addition you have the multi-national European composition in the supervisory board and in the top management. We also try to spread our different nationalities among the national companies. The company can be said to have about a dozen home markets comprising 145,000 employees of whom roughly half are inside the Common Market, and half outside.

With this structure in Europe we try to combine the economies of scale in production (similar to Sandvik with its niche policy), its technical and financial resources, and its combined distribution channels with the remaining national companies in the respective countries along with their domestic profiles. You have to be French in France, you have

# ABB - Organization

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## Decentralization - Matrix organization

to be German in Germany, etc.

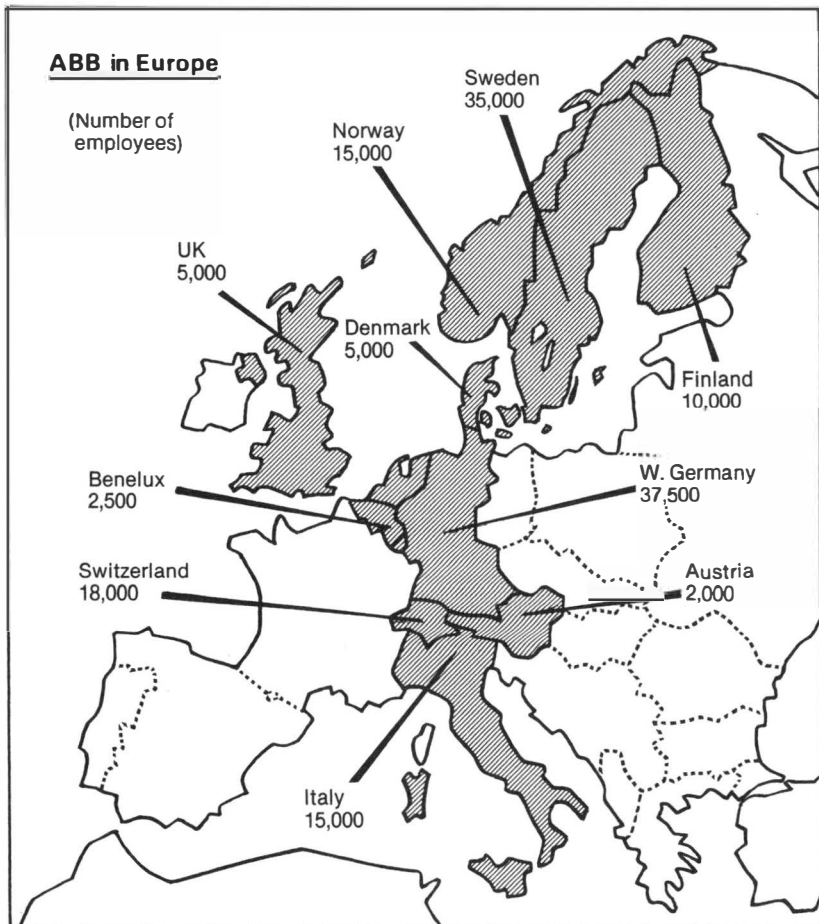
In order to avoid being smothered in bureaucracy we have created 3–4,000 profit centres, legal entities with their own balance sheets. What we have then is a big fleet of small ships, each run by managers with a responsibility for profits.

There is a very difficult balancing act here. You both want to coordinate and to provide freedom. Whenever in doubt here, my principle is: decentralize, let them go their own way, and take the trouble of overlapping, confusion and internal competition.

But on the other hand we do face some major opportunities for coordination. For example, before the Westinghouse deal there were 44 transformer plants around the world. This is of course a fantastic opportunity. If research can be centralized, the research cost for all these plants can be lowered. Also, there is considerable scope for plant specialization. If you look at the tens of thousands of electrical products in areas like low voltage apparatus, where there are 20,000 products, there is obvious overlapping between different countries with their own plants. You can construct matrices and then say, Heidelberg, Germany, should concentrate just on contactors, or Sace, Italy, should get out of something else and just make breakers.

## ABB in Europe

(Number of employees)



## The ABB Strategy on the European Market

Within this European structure we thus try to achieve specialization, sometimes down to two plants, sometimes one plant. For products that are tradable the advantages can be exploited without waiting for 1992.

As regards the European Market as one single market, I would say the situation now is as follows for a company like ABB: We have products like AC motors, where economies of scale in production can be exploited to 100 per cent, as there is practically no other limitation than closeness to customer.

Then there is a category like low and medium voltage switchgear. In principle there are no EC obstacles here. But there are a lot of different electrical standards that have not yet been cleared up. This is on the agenda for Europe later on. We have access to perhaps 75 per cent of the market, the remaining 25 per cent not yet being available to us.

Then there are products like locomotives and trains, turbo generators, power transformers, where we have access to say 25–50 per cent of the market. We have, for example, six traction motor factories within ABB. But when we build a locomotive in Germany for Bundesbahn, we have no traction motor factory in Germany. We could make the traction motor in Switzerland or in Austria, but Bundesbahn would not accept a Swiss or an Austrian one. Hence, we have to buy the motor from Siemens or AEG, our competitors, in order to get the complete locomotive. Obviously, when you can reduce these six traction motor factories to one, or perhaps two, big savings can be made. Until that time you can perhaps make a winding for a traction motor in one country, and move it to the other country.

Our strategy in this respect, then, is that we move, as fast as the politicians allow us, towards a more simplified production structure. Without 1992, we are in a good position, because we have, in contrast to most competitors, plants in all the countries. And we produce where they are prepared to buy from us.

Now, with 1992, our competitors get a better situation, because they can start to send goods to other countries, from just one plant. Perhaps it might seem as if it would be better for ABB not to get 1992. However, we are in a uniquely favourable position when the borders open up, because we have the distribution network and customer contacts ready. You cannot come in as a newcomer and deliver a locomotive. It takes maybe 10, 20 years to build up a reputation, with spare parts,

service reliability, etc. So we can move quickly, as soon as a free flow of goods and services between the countries is opened up.

Even more important, we do not only have European competitors, we also compete with the Japanese and the Americans in the USA, and on third markets. In these markets, we can only be winners if we take full advantage of a free flow of goods in Europe and thereby reduce unit costs. The non-European companies are for me the most important competitors, and that is why we are very eager to push on into 1992.

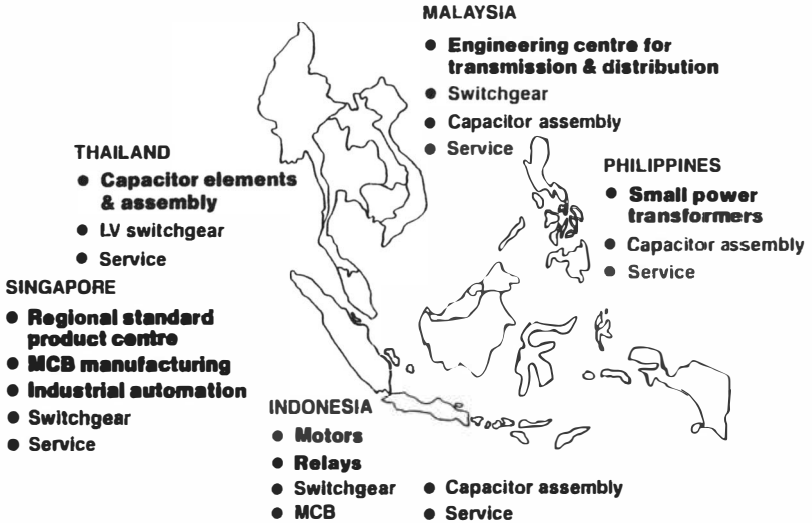
## A Strategy for the Developing Countries

Let me say a word also about the developing countries with their special situation. There has been a dramatic shift in world power consumption during the last decade and a half. In 1973, 80 thousand Megawatt was installed per year in industrialized countries, and 15 in developing countries. In 1983 the latter figure had risen to 40 while the former was reduced to 30. Now, the problem was that all the plants for production of power generating equipment were located in those countries where they were not required anymore. In the countries where demand was located, there were neither factories, nor money to buy plants. This was a difficult equation.

There is of course a tremendous need for infrastructure investment for electrification, transportation, telecommunication, water supply, garbage handling, etc. in developing countries. It is just mind-boggling to see the enormous investments that are needed in places like e.g. Mexico City. Today, the rate of electrification investment is about 40,000MW, e.g. about US\$ 50 billion, per year. The developing countries would need 125 billion, per year to sustain a GNP growth of 4 per cent, given the present rate of population increase. That is 2 1/2 times larger than the figure that they have now. But it is far beyond their financial capability to import that equipment.

You have to produce inside these major countries. You must be an insider, not an invader. You have to transfer technology into these countries, via joint ventures, license arrangements, etc. Sometimes you have to adapt technology to a low technology environment. Counter-trade is not really helping world trade, but for an individual company that is one among many financial engineering solutions to deal with a difficult payment situation. We have also tried to persuade the Euro-

## ABB Manufacturing and Engineering in South East Asia



pean governments to assist with foreign aid money to build power plants in these countries. That would give the best return for the developing countries, because without electricity they are not going to go anywhere.

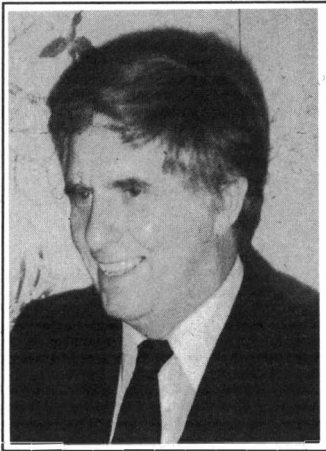
Some of these countries are too small for big plants, and then you must do like we have tried to do in Southeast Asia. Within the Asian group, we set up 15–20 plants and specialize among them. In Thailand we make capacitors, in Malaysia we make capacitors and switch gear, and we move now into Indonesia with relays and motors. Gradually, these plants start to act like a region with inter-trade and certain advantages for trade between the countries. This process has, unfortunately, been very slow. The gains have been mainly political so far, although gains from trade have now started to appear.

## Global Alliances

The ABB merger created something of a stir in our industry. People started to ask themselves what should be done now. You have read about the Whirlpool – Philips venture in white goods.

Can we create new alliances? Can we achieve structural change at that level; between the trading blocks? One such move is now under way. We signed a tentative agreement with Westinghouse last spring, where we bring technology and they bring a market in the USA to the party. Thus we are trying to produce a synergy effect also between the continents. Our partnership with Westinghouse is an important example of what I would like to call global alliances, which now are emerging.

# Learning from abroad. Skills, Structures, Productivity and Education



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The work of Professor Harvey Leibenstein emphasises the idea of "x-efficiency". This concept denotes features, such as management style and environment, which determine output, apart from the more clearly visible inputs. Leibenstein noted that there could be wide disparities between identical product firms in the same country which were attributable solely to differences in organizational efficiency.

This paper emphasises that, in the global economy, concepts of the market should not be confined to products, commodities or services. There is also a market – a place of exchange – for ideas in how best to organize production, create skills, arrange effective structures for labour associations, and adapt technological change.

The gist of improving technology is transformation – as the OECD (Dahrendorf) Report notes: "It is not displacing people so much as changing what is required of them." Some Australian experience in this process of trying to change what is required of people, by translating to

Australia, work habits from abroad, is detailed. A CEDA survey of the efforts of firms to apply the Japanese "Just-in-Time" (JIT) system is mentioned. The resistance to change, and the reasons for this, despite the obvious advantages of JIT, are highlighted. These difficulties in creating a more productive culture in firms are confirmed in a Committee for Economic Development (CED – United States) study which concluded that: "...the new technology itself is not resisted, but it is difficult to bring the social organization into line with its requirements."

Despite these resistances, it is possible to point to positive, excellent results where management and unions co-operate to adopt alternative methods of working. Studies by CEDA and the Economic and Planning Advisory Council (EPAC) show a number of illustrations of startling productivity increases where simple rules of work arrangement, modelled on European and Japanese practice, are adopted.

Equally, however, inherited practices of organizational structure taken from abroad, such as Australia's British-derived craft-based unions, can seriously undermine efficiency. Union organization in too many small entities retards multi-skill formation, and creates inflexibility. The challenge for Australia and indeed all countries in one global economy is to continually monitor institutions, wherever they may have been inherited from, to ensure that they are adapted to the requirements of a modern, innovative economy. This observation is underlined by reference to the Australian pattern of education investment and performance, and the need for it to begin initiating some of the more flexible habits of the United States system. A more microcosmic example of learning from abroad is also cited in the work of the British National Institute of Economic and Social Research which has examined, for instance, the relationship between education, productivity and training in West Germany and Britain. Again, in this illustration, it is possible to learn from abroad by examining different methods of approach to work and the training which equips employees.

The paper concludes by emphasising that learning from abroad is part of a wide process, which includes structural adjustment mechanisms, that many governments – including Australia's – are encouraging. It is no longer possible for smaller nations, such as Australia, to hide poor economic performance behind the excuse that their populations are too tiny to permit a flexible, sophisticated economic structure. The host country of the conference, Sweden, is itself the answer to this

weak proposition. Sweden, with a population far smaller than Australia's has an adaptable, outward looking economy, with industrially sophisticated and excellent products that compete effectively across the world. This may be a hard lesson – but, to succeed in one global economy, nations must learn from abroad, including how to create that elusive object – a productive culture.

## Adaptability and Growth

There is a widely acknowledged need for increased productivity, and greater adaptability, in the pursuit of improved international economic growth. Among the necessary components of greater flexibility is an enhanced ability and willingness of employers and employees to respond to a more growth-oriented overall economic policy. It is highly desirable that economies adopt best-practice skill formation, education and management techniques, even where there may be cultural or social inhibitions and resistances to change.

As economies have become more inter-connected or internationalised, there has been a great growth of interchange in technology, as well as in organisational and cultural habits and practices in the workplace, and more generally in institutional structures. Growing technical and cultural intermingling between economies should not be allowed to mask great differences which underpin international transfers. Nonetheless, there are some common currents influencing the processes of skill formation, work organisation and institutional innovation in different countries.

This paper outlines some of the changes necessary in labour markets, if they are to become more flexible and effective in creating skills, and the role of international transfers in providing increasing flexibility, skill enhancement and institutional adaptability.

## Transformation: the Gist of Technological Change

Under the chairmanship of Professor R. Dahrendorf, an OECD study in 1986 reported on relevant policy options for government in improving labour market flexibility.<sup>1</sup> Among the inter-related needs perceived by the Report were (a) capacity for economic adjustment to shocks, such as those emanating from energy, inflation, interest rates, and changing patterns of international trade; and (b) innovation, both

through technical invention and new form of organization. The Report emphasised (para 14) that:

”There is no one package of measures which can serve all countries equally well. The issues and packages which we have singled out as options need to be adapted to specific conditions. Moreover, this is not a reluctant conclusion; cultural uniqueness is also a source of strength. In other words, we believe that there is more than one route which leads to the goals of effective adjustment, continuous innovation, higher employment, and a better quality of life.”

The Report also distinguished six overlapping categories of factors affecting the flexibility of labour markets: labour costs, broadly defined; employment conditions; work practices and patterns, including working time arrangements, and the environment and organization of work; labour market rules and regulations; mobility; and education and training.

Of special interest was the Dahrendorf Report’s emphasis (para 48) on the relationship between technological change and occupational mobility:

”The gist of technological change is transformation. It is not displacing people so much as changing what is required of them. This is why it requires adaptability within given employment settings – whether large enterprises or secure contracts – rather than mobility between such settings.”

## A Learning Society: Transformation Processes – some Australian Evidence

The Dahrendorf Report’s emphasis on ”changing what is required of” people in the workforce strikes a very familiar note in Australia, where the exigencies of declining terms of international commodity trade have pressed policy makers to create greater labour and overall economic productivity. Some of these experiences carry messages of general international relevance.

Commentators in Australia have been aware for many years that, as Professor Bill Ford noted, ”the balance of skills will be critical in determining a nation’s comparative advantage ... and its standard of living”;<sup>2</sup> and that, ”in a rapidly changing world, Australia is becoming a comparatively underskilled and vulnerable nation, unable to meet the aspirations of many of its people, organisations and governments”.<sup>3</sup>

But it was only in the mid-1980s that policy makers began to show manifest concern with creating an "Australian productive culture". This followed the very substantial decline in Australia's terms of trade, by 14 per cent in the eighteen months to June 1986. The view enunciated by Professor Ford has come further into prominence:

"Skills and skill formation are central to the development of a productive culture, but so are adaptability, commitment, innovation, participation, technology and work organisation. It is essential therefore that skills and skill formation are not discussed in isolation from other requirements of a productive culture . . ."<sup>4</sup>

## Learning from Japan: Trying to Introduce JIT to Australia

Cross-cultural learning implies learning *from* other societies. Japan has shown how new knowledge and technology can be infused in one culture, borrowing initially from industries in other different cultures. It seems strange, therefore, that some believe that the challenge of changing to a more productive culture – learning from Japan – can be avoided, since Japan's productive culture is said to be unique. This is far from being so. It can and has been done in some segments of Australian industry. Unfortunately, however, there is resistance to changing others.

"An example may illustrate these points – the introduction of the "Just-in-Time" (JIT) system to Australia's automotive industry (i.e. including car and component-part manufacturers). CEDA has recently published a survey by Mr Wayne Mortensen on this issue.<sup>5</sup>

The JIT or Kanban system refers of course to procedures designed to produce and deliver finished goods just-in-time to be sold, sub-assemblies just-in-time to be assembled into finished goods, fabricated parts just-in-time to go into sub-assemblies and purchased materials just-in-time to be transferred into fabricated parts. The basic principle is cost reduction by eliminating all non-value adding activities through using fully the capabilities of employees, and by ending typical non-productive costs such as over-production, inventory, work in progress, rework and scrap, transportation, floor space, queuing and equipment breakdown.

There have been some outstanding successes with application of JIT. For example, one automotive-parts manufacturer has identified the following gains from the system: set-up times were reduced from 90 to

15 minutes; there was an inventory reduction of \$340,00 in value, and a doubling of stock turns; throughput time was reduced from 10.6 to 3.6 hours; quality improvements of 35 per cent were registered; and new rental areas were no longer needed as space was saved by JIT.

But despite successes such as these, and industry knowledge about them, Australian businesses have been slow, even reluctant, to adopt JIT. As Sir Arthur Lewis noted many years ago:

”There is always a gap between what is known to the experts to be the most effective way of doing things, and what is actually done by the great majority of people.”<sup>6</sup>

Clearly, knowledge must both grow and be diffused. Application of new ideas depends on community receptiveness and not merely on the results of changes for profits. In the CEDA survey by Mortensen, it is made plain that, despite the obvious profitability of successful JIT introduction, inbuilt resistance to change has prevented the more widespread application of the system in Australian industry. Although there is impressive evidence that JIT improves profits, Australian industry has been slow to explore and exploit the opportunities offered by the system. Why is this so?

The answer is no doubt complex. Lewis (p.180) has suggested that new ideas will be adapted most rapidly in communities where there is a history of changes and people are consequently more amenable to new ideas: ”A country which is isolated, homogeneous, proud and authoritarian is unlikely to absorb new ideas quickly when it meets them.” To these features could be added the further dimension of contrasting educational levels between societies.

But despite this complexity, and the problematic nature of inter-societal comparisons between countries such as Japan and Australia, it is clear from Mortensen’s survey that resistance to application of JIT in Australian industry comes from its implications for the relationship between management, employees and unions. Major changes in work organisation are necessary to implement JIT, and these depend on successful, close co-operation between employees, their unions, and management. Unfortunately, there are high barriers to this co-operation, such as lack of trust in companies, ineffective communication, language difficulties, union attitudes, reticent employees, lack of training and, above all, absence of a stable employment environment.

The importance of the issue of a stable employment environment is especially great since one notable advantage of JIT is that it reduces

labour requirements. Here the co-operation of labour with management is clearly of the greatest concern. Moreover, the expectations which employers have of employees is intricately involved in the change to JIT manufacturing. One Japanese plant established in the United States classifies all unskilled workers in one grade, compared with eighty-one classifications in a similar US factory. The flexibility of the Japanese system enables far greater adaptability in meeting the additional duties which typically accompany JIT, such as self-inspection and self-quality control.

For changes in job tasks and responsibilities flowing from JIT thus raise many issues. For example, should pay be linked to traditional job classifications? How are extra responsibilities to be rewarded? Where workers have been paid previously for maximizing output through bonus schemes, how should they be remunerated for producing goods just-in-time? These and other obstacles have discouraged Australian firms from adopting JIT, despite its consequences for profitability.

The conclusions of the CEDA survey on JIT are strongly re-inforced by results of a study undertaken for our counterpart organization in the United States, the Committee for Economic Development (CED). In their contribution, "Productivity: The Industrial Relations Connection", McKersie and Klein survey forty CED member organisations to identify current managerial beliefs and actions on workforce and industrial relations issues. Respondents ranked resistance to changes as the prime restraint. This applied for almost all groups, such as large and small, organized and union plants. The authors note:

"The establishment of new classifications, duties, shift arrangements, and the like required by new technology arouses substantially more opposition and even outright resistance to change. In other words, the new technology itself is not resisted, but it is difficult to bring the social organization into line with its requirements."

McKersie and Klein found several possible explanations of the inability of organizations to realize their full production potential. Among these were that:

"The technical requirements have moved ahead of the human capabilities of the organization (and) . . . Management has lost some of its effectiveness."<sup>7</sup>

It is easier of course, to keep the older ways, especially if industry protection is there to provide barriers to overseas competition. Unfortunately, this is also the road to economic lethargy and decline. In

Australia as in the United States and elsewhere, it is essential to overcome the inherent obstacles to productive change in the workplace which spring from entrenched habits and practices. To do this requires energetic adoption of efficient techniques of management and organization which have been successfully applied elsewhere. If this process of transnational learning is stymied by domestic conservatism, growth in the international economy in general – and not just in those countries which refuse to learn – will be undermined, as aggregate efficiency is less than its potential.

## Learning from Europe and Japan: Industry Organization Structures

There is no doubt – as the CEDA and CED examples show – that differing productivity levels between nations are partly determined by relative production process efficiencies; and that resistance to change (such as through an inhibition to learn from experience elsewhere) can limit economic improvement. The JIT case study mirrors the well-known work of Professor Harvey Leibenstein, who pointed out that there could be wide disparities between identical product firms in the same country which were attributable solely to differences in organizational efficiency. Leibenstein coined the phrase "x-efficiency" to denote features, such as management style and environment, which determined output, apart from the more clearly visible inputs.<sup>8</sup>

The same point has been emphasized for Australia by Professor Richard Blandy and his colleagues, who are critical of the limited understanding given by "a mechanical and mathematical analysis of economic growth based on an assumption of complete knowledge (including knowledge of the future) and concentrating on the direct relationship between measured physical inputs and outputs".<sup>9</sup> The Blandy book suggests that "social arrangements" in a work context are key determinants of productivity growth and these arrangements in Australia are unsatisfactory, and need to be revitalised: improved productivity depends on considerable changes in social organization of firms and of management and labour attitudes. It will be useful again to mention the Australian experience, and to generalize from it.

First, management attitudes leave much to be desired, and have not moved sufficiently from techniques adopted from another society at another time – a telling illustration of how international migration of

ideas can be counter-productive unless there is continual revision and review of their suitability and relevance. In his forthcoming CEDA work *The Causes of Slow Productivity Growth in Australia*, Dr John McCombie notes that Australian management may still be too closely wedded to the ideas of "scientific management" developed by Frederick Taylor in the United States at the turn of the century. The aim here is to divide the production process into its most efficient specialized components, producing simple, often boring repetitive jobs, with work pace dictated by the speed of the assembly line. The most favoured production method in this approach is usually determined by management, without consultation, and can consequently create confrontation. Blandy and others note that:

"Australian management has been amongst the most conservative in holding to the 'scientific management' perceptions of their task ... For most managers, it is far easier and safer to operate as a traditional supervisor within an hierarchical organizational structure. Information can be controlled, options kept confidential, and criticism muted and channelled."<sup>10</sup>

But the gains from innovation and change can be substantial. Blandy and others document the example of the Dutch-based Philips company's television assembly plant in Australia, where productivity was as much as 40 per cent below that of the firm's comparable plants in other countries. This low productivity was tolerable behind protective tariffs, but when these barriers were about to be reduced, management co-operated with unions to greatly re-organize the plant's operations. Adopting European practise, the continuous assembly line was replaced by small autonomous groups with discretion on details of how the assembly process occurred. Combined with an improved working environment, most impressive results were obtained: in one year, productivity rose to 120 per cent of the average of Philips factories elsewhere, and labour turnover fell from 120 to 20 per cent a year.<sup>11</sup>

These results are almost startling, and perhaps unusual, but they reminded us of Leibenstein's work mentioned before, and his claim that losses due to x-inefficiency were likely to be a multiple of those emanating from resoallocation through monopoly and tariffs.

This message is confirmed in a series of case studies made for Australia's Economic and Planning Advisory Council (EPAC) by Dr Duncan Macdonald. Changes were found to have occurred in a number of businesses in response to pressures generated by Australia's

deteriorating external position: reforms included new methods of employee participation; and dramatic alterations in work organizations, such as replacement of assembly line structures with more flexible ways of operating that give employees greater discretion and responsibility. EPAC notes that:

”Increased commitment resulting from these changes and reinforced by personnel practices based around Japanese principles of lifetime employment have, in a number of cases, resulted in increased productivity both in terms of quality and quantity. . . certain features have emerged as significant for productivity improvements. . . ”Japanisation” has also shown to be successful especially in relation to job security. Indeed this seems virtually essential for the smooth transition to new production methods involving new technology. An emphasis on skill formation and life-time training is another aspect of ”Japanisation” that has proved to be important. . . ”<sup>12</sup>

Dr Macdonald’s study mentions a number of examples of productivity improvement in Australian industries which sprang from adopting simple rules of organisation and management from abroad, especially Japan. One example concerns Mitsubishi, when it took over the Chrysler company and began stressing management – union co-operation, including participative personnel and industrial relations practices, and job security assurances. Dramatic changes to work processes, including introduction of the JIT system, helped increase productivity to the extent that the number of man-hours needed to build a car fell from 60 to 22, labour turnover declined from 55 to 12 per cent a year, and absenteeism from 9 to 5 per cent. Another illustration in Macdonald’s survey is from the steel industry, where the inefficiently high number of job classifications were reduced from over 100 to only 6, with a wider range of skills for each classification.

The themes of Dr Macdonald’s work for EPAC are borne out by a small survey of CEDA member firms conducted by Wayne Mortensen. Mortensen asked five questions of four companies with strong Japanese management associations, either as subsidiaries of Japanese parents or as part of a joint venture: Air International, Nissan, TRICO and NEC. The results are to be set out in separate CEDA publications, but responses to one question may be mentioned here. The companies were asked how the Japanese approach to production and labour management had been adapted to the Australian scene, and why this was necessary. Mortensen found that the four companies had introduced

many features of the Japanese management pattern, especially JIT, improved quality control, evaluation of processes of production and task execution, multi-skilling, job rotation and employee participation. Advanced technology introduced from Japan had strongly influenced production organisation, and some of the firms had registered spectacular productivity improvements.

Clearly, the management techniques which reap greater productivity can at times move from one country to another, as multi-national companies shift personnel and capital across borders. Clearly also, internationalised labour markets mean that one country can learn from another's techniques. As with JIT mentioned before, Japanese techniques have been of special interest as possible models for international transfer. As the CED study's chapter (by Norsworthy and Malinquist) on recent productivity growth in Japanese and US manufacturing noted:

"...the role of labour relations in Japan should not be underestimated. In general, workers' willingness to accept and accommodate to new technology is an important element in the cost of introducing new capital equipment and new working techniques. And that willingness may, in turn, derive partly from the job tenure system that guarantees lifetime employment to many Japanese workers. So it may be that labour management relations in Japan have indeed played a major part in smoothing the assimilation of the new technology that has resulted in rapid labour productivity growth."<sup>13</sup>

## Unions

A *second* aspect of industry organisation structures concerns unions. In this context, there has long been transnational migration of institutional patterns – sometimes to the detriment of the receiving country. Australia is a classic example here. In Chart 1, Australian trade union sizes are shown. It will be seen that about 70 per cent of members belong to 10 per cent of unions. Only 20 per cent of unions account for 90 per cent of total union membership. This leaves nearly half the Australian unions with less than 1000 members each. It means that of Australia's 3.18 million trade union members, 1.7 per cent belong to 155 unions with less than 1000 members each, and 7.8 per cent belong to 239 unions having fewer than 5000 members each.<sup>14</sup>

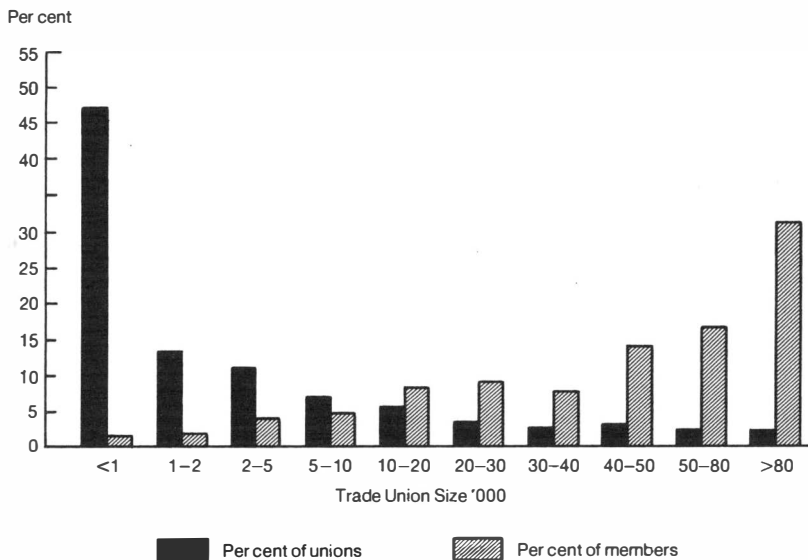


Chart 1: Australian trade union sizes

Australia's failing in having an excessive number of unions produces many adverse consequences for industrial efficiency. In particular, there is great scope for inter-union demarcation disputes and for restrictive work practices. As one employer's association representative has said:

"The Australian community has unfortunately saddled itself with a traditional system of work classification which makes an inflexible workforce virtually inevitable. Nowhere is this more apparent than in the metal industry, where the employee's competency to perform work is determined by membership of a particular union."<sup>15</sup>

It should not be surprising that, with over 300 unions, there is an excessive number of demarcation disputes, and a welter of restrictive work practices. A simple set of tasks, which could be undertaken by one employee, requires instead several people, each from a separate union. It has been noted of one dockyard that:

"No less than 21 unions organize the 1800 strong workforce which is covered by 14 different federal and state awards. This situation produces constant demarcation skirmishes and jealous defence of the traditional skills, workpractices and craft boundaries that are especially

prominent in the ship building industry, and would obviously need to be rationalised if the yard were to be competitive.”<sup>16</sup>

The craft-based unionism structure in Australia is the product of institutional migration, since it is modelled on the practices of Britain. While perhaps logical in another style of economy at a previous time, this borrowed pattern of organization is now very inefficient and counter-productive. To change the pattern, Australia is now looking elsewhere for a replacement model, and its major, central union organization, the Australian Council of Trade Unions (ACTU), has lighted on the example of Sweden and other countries. One fruitful new development is that legislation proposed at the time of writing (June 1988) provides that, by 1992, no union will be permitted to retain registration and official standing if it has a membership of less than 3000. Small unions will be encouraged to merge on an industry basis with larger ones, creating eventually about 25 "super" unions.

### Skill Formation and Education: Following Overseas Examples

The sometimes adverse effects of borrowing another country's organizational pattern, irrespective of local requirements, and of leaving it unchanged, irrespective of altered needs, have been illustrated by the example of Australia's union structure. Based on the British craft-defined model, the Australian labour market has become too rigid and inflexible, as a result of this system. In particular, multi-skilling has been discouraged in the workforce because of the intricate demarcation rules induced by the large number of unions. In Australia, too many employees have been trained to occupy only one confined occupational box, with very limited opportunity to go beyond it. This is in contrast to labour markets such as Japan and West Germany, where employees are given a range of skills, and encouraged to be conscious of the overall production process.

The relative inflexibility of the Australian system is accentuated by the organization of apprenticeships, which reinforces the narrowness of skills in its neglect of emerging technologies and adherence to traditional occupational classifications. It also emphasizes the length of time served, rather than competence – that is, quantity instead of quality – and apprenticeship intakes can fluctuate erratically from year to year. Moreover, there are relatively few Australians enrolled in technology

courses – only between one third and one half of the proportion of those in the United States, Britain, West Germany and Japan. And there are limited opportunities for young people in Australia seeking vocational preparation after leaving school.<sup>17</sup>

In its comparative expenditures on education as a share of total resources, Australia does not fare badly in the international league tables. (For example, in 1980, as a proportion of GDP, Australia spent 7.2 per cent on public and private education and training. This compared with 8.7 per cent in the United States, 7.8 per cent in Japan, and 7.3 per cent in West Germany). But this has not produced a good Australian performance in relative higher education attainment, compared with major OECD countries. For example, Australia's poor performance is clear from Table 1.

*Table 1: Higher education attainment, 1985\**

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Japan	35
USA	32
UK	27
France	25
West Germany	21
Holland	18
Australia	16
Italy	9

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\* Percentages of the relevant age-group gaining first degrees or higher diplomas.

*Source: EPAC, An Overview of Microeconomic Constraints on Economic Growth, AGPS Canberra 1988, p. 91.*

Moreover, in the pattern and organization of its education institutions, Australia scores poor marks for flexibility. Again, as with the union structure, Australia has inherited and perpetuated a higher education system that misallocates scarce resources, and falls to adjust adequately to meet the demands of the modern market place. In this deficiency, Australia needs to examine alternative means of organising higher education, which has such a key role in raising productivity throughout the workforce: a lack of human capital is a major constraint on economic development. (Furthermore, education is a good potentially important export service.)

What are these alternatives? It is here that the advantages of examining overseas methods of organizing this central aspect of skill formation is clear. The Australian university system is almost completely Government funded, with centralized control; excessively uniform; inflexible; and failing in its essential role of providing a flow of graduates in response to changing economic demands. The budgetary allocation process within universities is designed more to protect the status-quo between faculties than to shift resources effectively. Staffing policies are also geared to ensure uniformity rather than to encourage or reward productivity.

Fortunately, the force of economic circumstances has ensured that the Australian government is at last looking to other ways of organizing creation of high skills for the workforce. Reform is in the wind, as the United States pattern of higher education is being copied more closely: Australia now has its first private university; students in government financed institutions are being threatened with fees; faculties are being encouraged to create links with industry for joint research initiatives; and the old rules of tenure, security and non-review of academic staff performance are being questioned. These developments are another illustration of the potentially constructive aspects of international comparison, and of learning how greater flexibility can be sought – despite local resistance and inertia – from elsewhere.

### A More Microcosmic Example

There are also other ways of learning about gaining improved productivity through increased skills. These come through studying at a detailed level the relative satisfactoriness of the education and training systems of different economies, and applying the lessons derived from these. A good example here is the work of the (British) National Institute of Economic and Social Research, under Professor Sig Prais. This has compared Britain and West Germany in the amount of vocational training for mechanical fitters, electricians, construction, office and retailing workers. In one of a series of studies, Prais and Wagner concluded that German craftsmanship was far stronger than British, largely because of better schooling (rather than vocational training) in Germany. And the better education in Germany was attributed to the type of curriculum used, rather than to the extent of resources devoted to education.<sup>18</sup>

In the same sequence of studies, Anne Daly's work for the National Institute provides some interesting answers to the question of the relationship between education, training and productivity. Daly's "matched product pairs" analysis of 36 British and German firms studied simple products in the metal trades. Even for very simple products (where small productivity differences might be expected) there was substantial variation: German productivity was, on average, 63 per cent higher than British in the firms studied. The difference in productivity was explained, not by capital equipment age, but by the workforce's ability to service this equipment. In turn, the relative ability to maintain the machinery depended on simple assumptions and practices of management: in Britain, the foreman had often been promoted to that position purely on the basis of length of service, whereas in Germany qualifications as well as experience determined promotion. Daly's study found also that the type of education possessed by senior managers was an important part of the explanation: German managers were mainly graduate engineers, whereas British managers were from company sales and financial divisions. Daly noted:

"This difference in technological qualification has become even more important because, as we were told at several interviews, non-engineers are less receptive to technological innovation; their lack of technical understanding leads to delays in installing technologically complex equipment because they are afraid to "chance their arm".<sup>19</sup>

These simple implications for productivity of different practices and attributes between countries show again, form a microcosmic vantage point, how one nation can learn from another. An internationalized labour market, and competitive pressures, impel firms and governments to examine alternative education and training systems, as well as management and workforce habits, in other countries. Unless they do so, and try to adapt to better ways of producing goods and services, they are likely to fall behind in economic growth performance.

## Learning from Abroad: Part of a Process

Economic growth does not of course depend merely on studying overseas success stories and applying the results in one's own country. There are very many features which determine faster growth, and one which is frequently mentioned is removal of domestic barriers impeding industries from responding flexibly to economic changes. It is most

important for government to create an atmosphere in which productivity can rise and competitiveness improve. But it is not possible to rest too heavily on general proposals to improve competitiveness. Knowledge is growing of the various specific factors which create industry competitiveness, and commitment to expanding trade. The Geneva-based European Management Forum, for example, releases annual reports giving a comprehensive survey of industrial competitiveness in OECD countries. The 1985 Report used 302 measures under ten headings to rank twenty-eight countries. Industrial competitiveness is defined as depending on "the quality and cost of the resources that industry draws upon, the efficiency with which industry uses these, and the extent to which the general economic environment is conducive to competitiveness."<sup>20</sup>

It should not, therefore, be supposed that improved industrial efficiency depends only on an economic atmosphere created by government, and on the ability of government to remove general obstacles. There are also many spurs to improved competitiveness which can form within business itself.<sup>21</sup>

For Australia, this point has been well made by Mr Rob McLean of McKinsey and Co., for CEDA's Strategic Issues Forum, in a report entitled *Exploiting Opportunities in the Pacific Basin*, and published by CEDA in 1986.<sup>22</sup> Based on a survey by McKinsey and Co. of 170 managers of medium and large (CEDA member) Australian companies, the CEDA report concluded that the key elements necessary for success in Pacific markets were all within the scope of company initiative, and that there was no basic reason inherent in the Australian economic policy environment or cost structure to prevent success in Pacific exports. The key factors procuring export achievements were:

- study and awareness of changing market needs
- long-term commitment to the Pacific market;
- investment in appropriate skills and technology;
- an ability to deal with host governments.

In particular, the CEDA survey indicated that companies were not paying sufficient attention to non-price factors such as technology, quality, design and market-support services. Clearly, learning from abroad can help rectify this deficiency, as part of a broad process of trying to improve growth performances in Australia and elsewhere.

## Learning from Abroad: Part of Structural Adjustment

In introducing this paper, reference was made to the OECD Dahren-dorf Report on Labour Market Flexibility. Mention of another OECD work may be noted to draw my theme to a conclusion. Much of the attention here has been on Australia, the country's need for structural adjustment, and the subtle ways – including learning and skill acquisition from abroad – in which this might be expedited. But broader examples can be given. In its report on *Structural Adjustment and Economic Performance*, published last year, the OECD noted:

”The OECD economies have been severely hampered by rigidities and distorted incentives. These have contributed to persistently disappointing economic performance. Microeconomic policies can do much to raise employment and living standards ... Over the medium to long run it is the extent to which the flexibility, efficiency dynamism can be enhanced in each country and in international markets that will determine whether higher rates of growth and low unemployment can be achieved and maintained.”<sup>23</sup>

Although the OECD's observation is most pertinent, this paper has stressed the importance of creating a ”productive culture”, as it is sometimes called. Some of the newly industrialized countries, such as Singapore, have shown how trade performance can be based less on natural resources than on human endowments, such as skills and effective organisation. More pertinently perhaps, economies such as Australia's have to stop complaining that small size prevents their access to production structures which can adapt and compete with larger, more central economies. The host country for this conference is itself a nation with a smaller population than Australia's, and fewer natural resources. Yet its industrial performance, and great international reputation for product excellence in sophisticated, high value added goods, is there for all to see. We are told that one of the reasons for this achievement is the presence of a productive culture. It is this hard lesson that many countries, including Australia, must learn, and do something about. Growth, stability and employment require it.

## Notes

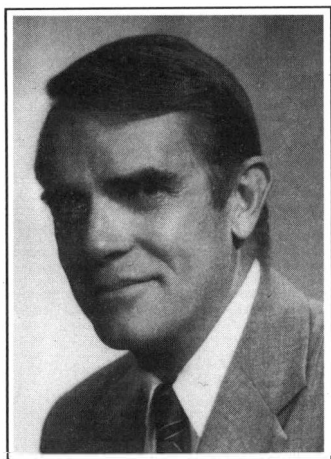
- <sup>1</sup> *Labour Market Flexibility* (the Dahrendorf Report), Paris, 1986.
- <sup>2</sup> G.W. Ford, "Human Resource Development in Australia, and the balance of skills", *Journal of Industrial Relations*, September 1982, p.443.
- <sup>3</sup> G.W. Ford, "Australia at Risk, An Underskilled and Vulnerable Society" in J. Eastwood et al. (eds.) *Labour Essays 1984*, Drummond, Melbourne, 1984, p. 54
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- <sup>10</sup> *Ibid*, pp. 69-70.
- <sup>11</sup> *Ibid*, p.23.
- <sup>12</sup> See D. Macdonald, *Work Practices, Industrial Relations and Labour Productivity*; and *Attempted Reforms in Human Resource Management and their Results: A review of experiences in Australia and overseas*. Papers prepared for EPAC and quoted in *An overview of Microeconomic Constraints on Economic Growth*, EPAC, AGPS, 1988, pp. 93-4.
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## Comments by a panel of Trustees



*Dean P Phypers*

Retired Senior Vice President,  
IBM Corporation  
CED

I am not qualified to comment on Australia, except to say that the fact that the brain power of Australia is focusing on these kinds of problems, is evidence that remote geography is no longer the answer to independence. So we are in a global economy. I certainly agree, that we need to learn from others, and that we need to learn how to manage globally. I will assert that we need to avoid protectionism as we do that. Why is that? We are in a world-wide global market economy today. We do not have the choice. We are there, and I think Germany also said, young men should get themselves on the side of the inevitable, and that is where we are.

Secondly, human protectionism is a human reaction. If we are weak, we want to protect our flanks and nurture whatever we are trying to protect. If we are strong we want to maintain a hard won position, but by definition, if one defines the global economy as one with optimal flow of resources, this approach will not work in a global economy. All the countries, all the national entities involved at the end of the road, want to improve their standard of living. That is always a function of comparative advantage.

I guess a common thread running through much of the discussion today, has been world competition. And I would like to talk for a

minute about an example which illustrates a couple of ways in which managing globally and learning from experience may occur. This is a parochial example, and it is quite different in most respects from the ASEA Brown Boveri examples we have heard earlier. It is an existence theorem that has been used for a long time. Of course I am talking about IBM, which has operated in over 120 countries for over 50 years. In the process, it followed the practice of building a world-wide product line, and the general principle under which all that was done, was to build a product where the market was. It used to be that we had an excess of 40 plants, 25 laboratories around the world. The product line was designed because of the same economies of scale mentioned earlier. An example would be here in Sweden, where Sweden has for many years had an organisation of about 4.200 people, 1.100 of which are in a plant, supported by a thousand vendors, that builds various kinds of printers for the European market. Those printers are large and small, relatively simple and complex, and are concerned with foreign languages, (i.e., foreign to Swedish, English and others).

Those products are integrated and sold whereas they are developed and manufactured in various national entities. We integrated and sold across all of the 120 plus countries. The need for integration of those resources and understanding of those cultures is obvious, in that kind of environment.

I want to mention just two of the major factors that attributed to IBM's success rate over a number of years. One is education. This is mentioned in Professor Nieuwenhuysen's paper, and of course is central. Specifically in 1986, the US company of IBM ran an equivalent of the 20,000 person university. In the Far East and in Europe, there are similar to scale activities, to bring it down to Sweden.

Last year, there were 40,000 man-days of education for the 4,200 people. Now of course a lot of this is aimed at trying to keep a place in a high-tech kind of environment. Broadly speaking and relative to the points, this is a mechanism which allows an institution to constantly deal with the issues of common goals, common principles, cultural differences, common practices, whether they be developing and manufacturing practices or personnel practices, cross-pollination of ideas – all aimed at serving, to close the loop, these common goals and this world-wide product line. In addition, at any one point in time over the recent years, there have been 8–10,000 assignees, (i.e. people who are assigned from their home country into some other country for appoint-

ments running as short as one week, or as long as three or four years), providing specialized skills to their assigned area as well as learning that culture. You can see, as the process goes on over a long period of time, you begin to build an international resource which is priceless in this kind of business.

The second example is a management system technique, which I always called best of breed. Conceptually it is very simple. It says that any profit centre manager in the business, is competition, and he is the best in the area. Why is he the best? How can one get to be the best and if one cannot get to be the best, why is he in the business? That sounds very simple, but it is very hard to determine. The concept must be installed in the management system with teeth, and by "teeth" I mean that the general management has to demonstrate that it is serious about its business – inspecting that business unit, asking questions and having the quality of the work that is done on those questions rewarded if it is good, and not rewarded if it is not good.

But if there is teeth in that kind of management system, it really forces those people who are in charge of that part of the business to look at their competition, understand what is going on and accept better ideas from any source. IBM uses this technique internally, that is we look from plant to plant, or laboratory to laboratory, and externally, in terms of competitive analysis. It helps those business unit managers and the general management magglegate to understand what business they are in, and it contributes to dynamism over time because nothing stands still in the world, it grows or it dies, and some should grow and some should die. Now, doing this in a world-wide environment, of course, is more complex because it is harder to gather data, harder to understand cultural differences, advantages and disadvantages, however, this is a reality in the place where I spent most of my working life.

I just mentioned this model and these two examples as ways to deal with the questions of learning from others and managing globally. I would put in place the caution again that you just heard, that one cannot lift these things intact from anywhere; one has to grasp the ideas and adapt them to his own situation and culture. But these are the kinds of things that I think are going to be more and more crucial as we move into this economy that is the subject of this conference.



*Nobuo Tateisi*

Executive Vice Chairman, Omron  
Tateisi Electronics Co.,  
Keizai Doykai

I am pleased to have this opportunity to address this distinguished gathering. As I am from a Japanese manufacturer, who has so far succeeded in surviving in a very competitive environment, arising from a very high appreciation of the yen as well as manufacturing imports, particularly from the NIC countries. Please allow me to make comments, specifically on the just-in-time-systems.

On the basis of Dr Nieuwenhuysens presentation, it is my hope that people here present will understand how Japanese manufacturers have made an effort to cope with the changing world. Dr Nieuwenhuysen mentioned many different reasons in his paper. Why greater efforts have not been made to implement just-in-time-system in Australia, even though the merits of the system are recognized. I have no intention to dispute these points, in my personal opinion, I see the following areas as being the largest problems.

The first, the country itself is not facing severe competition. The second, there is no competitive stimulus from surrounding countries. The third under the prevailing management practices, results are not available 3-5 years in cases where reforms have been implemented. Fourth. Are there top executives who try to anticipate future needs and requirements?

Is there a strata of middle level managers who have the necessary drive and capabilities i.e. to meet the expectations of top executives. And also, are there customs and structures that encourage people to

strive to display their abilities to the fullest extent possible. Here also there are reasons to examine why just-in-time has been so successful in Japan. I would like to share my interpretations with you. I think the main factors contributing to the success of just-in-time have been these. The first, total policy and quality control, total management. The aim was to prevent line stoppages etc. This has been promoted in small group activities, in which everyone has participated. The second, the concentration of production and distribution centres due to Japan's geographical conditions has also helped. Third, competition in Japan has been more severe than in other countries. Even in our company-case, in the field of control performance. Only in Japan we have more than 50 competitors.

Because the Japanese were originally a culture of people who participated in labour intensive farming, they are, by nature, very disposed to effective team-work. Fourth, workers have possessed inadequate skills. Fifth, the practice of lifetime employment has facilitated investment in employee education programmes, which has produced workers with multiple skills. This in turn has made it easier to transfer workers from one assignment to another. In our case, US \$ 253 per person annually, is spent on training and education. In Japan the fear of losing, being left behind in the race, has always been larger than the fear of breaking to additions. This is something that both labour and management have recognized.

The Japanese practice of having parts suppliers that are affiliated to major manufacturers has worked to create strong personal ties between companies. These ties have made it much easier to persuade people to introduce just-in-time-systems. Six, racial, religious and on lifetime conditions in Japan have made it possible to achieve full participation by all employees. Our companies, Omron, has recognized the need of the responsibility to the society as early as 1959. Then we established the motto of the company: "A better society and higher standards of living through our work." This motto is still being recited every morning by our 12.000 employees.

Seventh, the Japanese management culture allows people to take a long view of things. Now, at this point, I would like to describe some of the innovative steps our company has taken to promote efficiency and cost savings. This might be interesting to you. We call our programme of activities, action 61-61 which refers to the year "shova", 61 in Japan, or 1986. The year when our programme was launched. Under

this programme, we view our business activities, our floor consisting of six different blocks: development, sales, purchasing, production, distribution and investment recovery. Efforts are being made to implement total innovations that achieve the fastest cycle for this block. Our aim is to change our corporate constitutions, and thereby improve the companies profitability.

In the past, we mainly carried out value-analysis, and value engineering activities, separately for each function, such as development, purchasing and production. Although individual efforts achieved cost reductions, their effects tended to be merely temporary. Let me briefly outline the results. We have achieved action 61 by giving you complete figures without any complicated theory.

First, as a result of production innovations, we have greatly shortened our delivery time and production lead times. 70 per cent of deliveries to the customers are made within 1 day, whereas in the past it took anywhere from 2 weeks to 3 months. The remaining 30 per cent are made within 2 weeks on average. Production lead time has been cut from an average of one month to around 1–5 days. Second, as a result of innovations in product development and our variety-reduction action programme, we have reduced our product cost by 25 per cent on average. This has been achieved through the extensive use of standardized design. Third, thanks to innovation in our purchasing activity, we have lowered our procurement cost by 20 per cent in the last 2 years.

Fourth, as a result of innovation in manufacturing and adaption of the just-in-time-system, we have boosted productivity in the last 2 years by 30–50 per cent, on the basis of all kinds of products or equipments. Fifth, through innovation in distribution we have tremmed distribution expenses by 20 per cent in 2 years. This has been accomplished by reducing the number of temporary storage points and by shortening storage intervals. Sixth, as a result of innovations in investment recovery, we are now using our funds much more efficiently. This has improved our money-flow situation by 1 billion Yen, or approximately 7,7 million US \$ in the last 2 years. As these figures indicate we have achieved remarkable results within a short period of time.

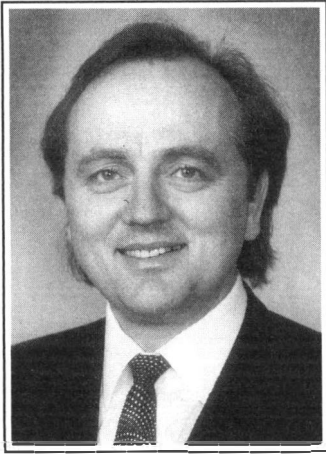
And the result of this innovative effort, our sales for fiscal year 1988 will be up 22 per cent compared to 1986, and pie-tax profit is expected to show an increase of 285 per cent. 40 per cent of this increased profit can be attributed to ex-sales expansion in the economy, and the remaining 60 per cent was analysed to have stemmed from the results

achieved under action 61. Now, during the past 6 years we have studied four international ventures in new business fields. These ventures are started by employees who became superfluous in other areas as a result of streamlining efforts made before action 61 was implemented. We have limited these ventures to activities that are related to our main lines of business, and to the use of assets and expertise, built up over the years of our existing operations. As a result, these new businesses have grown smoothly and this year they are expected to contribute around 12 per cent of our total sales. As for our overseas activities, we have now 39 bases of operations in 22 countries around the world, except for production facilities in England, Ireland, Thailand, Malaysia and China. Nearly all the bases are primary involved in sales. We are planning to adopt a system, independent accountability which will apply to over-seas bases to promote business activities that are more closely tied to their local communities. This is where we are now. Our companies has been doing, and will be accomplished by the year 1992. Our company has been trying to establish a complete base here in Europe, in view of the 1992 unifications in the EEC.

SESSION III  
Integration of  
World Capital Markets  
*Chairman: Dr Ralf Krüger, CEPES*



# International Capital Markets – Current Trends, Warning Signs



*Professor Pentti J K Kouri*  
Chairman, Kouri Capital

Your majesty, ladies and gentlemen. It is a special pleasure for me to be in Saltsjöbaden. Thirteen years ago in July 1975, I attended a conference here on exchange rate theory, organised by Professor Assar Lindbeck. At that conference, a new approach to exchange rate determination emerged – the asset market approach. The basic idea of this theoretical approach was that in a world of integrated capital markets, exchange rates will be determined in the same way as all other asset prices – stock market prices, speculative commodity market prices and bond prices, namely by the demand for and supply of assets. Consequently exchange rates will behave like all speculative prices.

Contrary to the old theory, the new theory of exchange rate determination predicted that in a world of capital mobility, exchange rates would be very volatile, subject to sudden changes and very sensitive to shifts in market sentiment. Such movements would not necessarily be related in the short run to any underlying fundamentals. Subsequent events in the market place have tended to verify these predictions.

In this context, it is interesting to reflect on the rough orders of magnitude in the global foreign exchange market. Total world money

supply is about \$10 trillion. Daily turnover in the foreign exchange market is well in excess of \$200 billion, of which daily trade-related payments are less than \$10 billion, while long-term financial transactions (foreign borrowing and direct investment) account for a further \$10 billion. In other words, less than 10% of the daily volume of transactions on the foreign exchange market is based on commercial transactions. The remaining 90% is speculative in nature.

Viewed in this perspective, the daily volume of trade in the foreign exchange market is quite staggering. The annual total is so enormous that it is difficult to comprehend – in the region of \$50,000 billion. The foreign exchange market is by far the largest market in the world today. As the Chairman has already noted, the foreign exchange market has also become a central part of this globally integrated network of markets comprising stock markets, bond markets, money markets and derivative markets.

## The Emergence of a Global Capital Market

I will start with a brief examination of the emergence of a global capital market. There is no doubt that a *global* capital market is emerging. All of the different segments are being integrated into one global market. Both trading and capital raising activities are being globalised. I see evidence of this in my own country, Finland, where the money market, equity market and capital-raising activities are increasingly integrated into the global market. Secondly, the scope of the market for tradeable instruments is expanding. Probably some 20% of the market is *securitised* i.e there is a secondary market for these instruments. This figure was previously much lower. As a result the relative position of traditional banks is declining. Thirdly, there has been a widespread *integration* of different markets: stocks, money, foreign exchange, bonds, options and futures. Fourthly, in my judgement, all of these developments will lead to further concentration within the securities and banking sectors, particularly in the United States. These markets effectively consist of 160,000 computer terminals linked together by telecommunication lines. The stock market crash of October 1987 provides a wonderful example of how all these markets are interlinked. The crash started in the money market and then continued into the foreign exchange and stock markets.

One of the factors underlying the growth of international financial markets and the emergence of new financial instruments has been the need for government finance. For example, Sweden had to develop a domestic money market to enable the government to borrow on more attractive terms.

One of the largest growth markets in the US has been the securitisation of mortgages. This is in fact a much larger market than the corporate bond market. The same development is likely to occur in Europe and other parts of the world. The real estate market is one of the places where securitisation is proceeding at a very rapid rate.

Let us look at some of the magnitudes in this global capital market. Stock market capitalisation amounts to \$8,000 billion, excluding the more exotic markets. World public debt totals \$6,000 billion. World private debt is of the order of \$16,000 billion. World money supply and bank credit totals \$10,000 billion or more. World real estate is in excess of \$15,000 billion. World inventories of metals are well in excess of \$1,000 billion.

## One Global Market

### *Potential Size (guesstimates)*

Stock market	\$ 8000 billion
Total public debt	\$ 6000 billion
Total private debt	\$16000 billion
Corporate	\$10000 billion
Mortgage	\$ 6000 billion
Household	\$ 2000 billion
Total potential tradeable claims on world wealth	\$32000 billion

What is emerging is a global gambling casino – a market place where all assets are being evaluated and priced almost twenty four hours a day. It sounds like a wonderful prospect, but a financial monster is being created that is well beyond the control of any government and well beyond the understanding of any economist. There was an amusing news item in the Herald Tribune the other day reporting on a conference held in the United States attended by many Nobel laureates. Two main issues were discussed: the stock market crash of October

1987 and its impact on the world economy. The conclusion of this eminent body was that they had no idea why stock markets crashed in October 1987 and they were equally unable to say whether or not it made any difference.

One thing that has been established by academic research is that there is far too much trading in these markets. In stock markets alone, the annual trading volume exceeds \$ 6,000 billion. A considerable volume of trading is required for these markets to perform their functions in terms of the raising of capital and allocation of savings.

There is also far too much volatility associated with these markets. Professor Schiller at Yale University has carried out research where he tries to explain the variability of the stock market in terms of certain underlying fundamentals e.g. changes in corporate profits, interest rates etc. The surprising conclusion of this research is that very little of the variability in prices can be justified in terms of fundamentals.

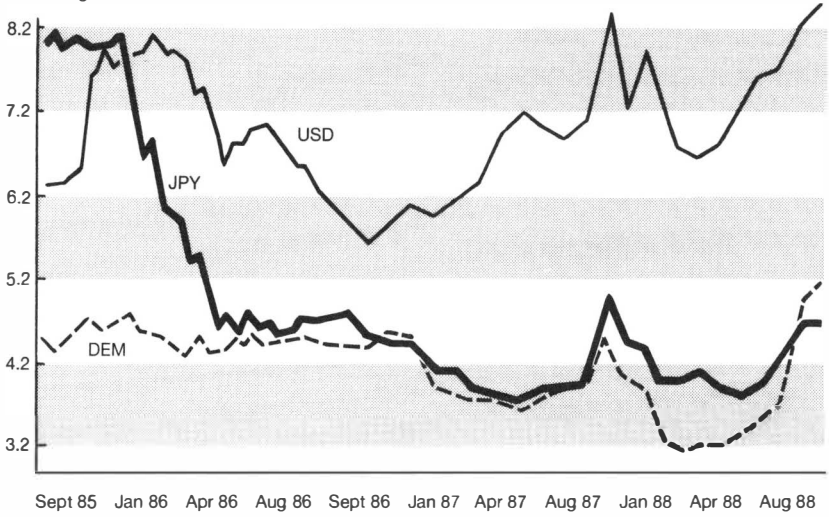
One rapidly growing and highly profitable area for investment banking today is M&A activity. In the US, the total value of transactions in 1987 was about \$170 billion. In Europe this is also an expanding field. Last year witnessed several major transactions such as the Nestlé acquisition of Rowntree and the ASEA/Brown Boveri merger. This is another significant trend in the process of globalisation. Much of this activity is driven by what seems to me to be sound fundamentals. Many of the industries involved are fragmented and need to be restructured into globally competitive entities.

## The Outlook for the World Economy and Financial Markets

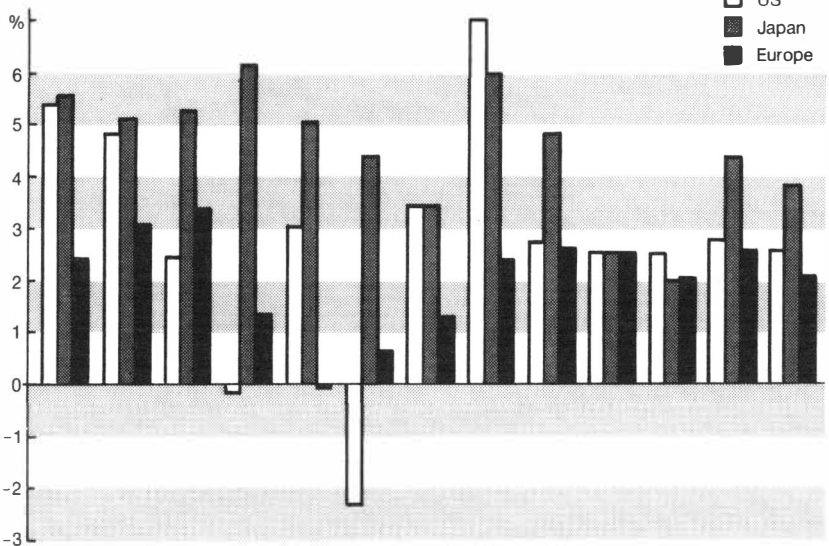
The title of my talk is concerned with "warning signs". Naturally the warning sign to which money managers and investors are paying attention today (mid 1988) is that interest rates are again rising worldwide as they were in the summer of 1987. It was this rise in interest rates that precipitated the subsequent stock market crash in October 1987. The present rise in discount rates has been particularly unsettling for stock markets recently (Diagram 1). The same picture also emerges from an examination of long-term bond yields. This development is likely to continue during coming months for the simple reason that the world economy is booming, particularly the United States economy (Diagram 2).

Euromarket Interest Rates & Month Rates

Percentages



OECD GNP Growth Rates



At Columbia University, exhaustive monitoring of worldwide current and forward indicators of economic activity is carried out under Professor Geoffery Moore, a highly distinguished student of the business cycle. Their latest assessment is that – contrary to the expectations of many observers – following the stock market crash, the world economy recovered and has been subsequently performing extremely well.

This is also borne out by an examination of the recovery from the recession induced by the second oil crisis in the early 1980s. The world economy started to recover in November 1982 with the exception of Britain whose upswing had started half a year earlier. Economic growth continued steadily until the pause of the stock market crash. Although the growth curves were then expected to turn down, nothing of the kind occurred.

During 1988, growth has been very vigorous in the United States as well as in Japan, where many observers believed that the appreciation of the yen would bring economic growth to a halt. Although growth performance was sluggish in Europe, growth has nevertheless continued.

We now have a situation where all indicators point to continuing vigorous expansion of the economy seven years after the start of the present business upswing. Utilisation rates in the United States are at basically full capacity, and unemployment is at its lowest level in fourteen years – virtually at full employment. Unemployment has also been cut in other parts of the world – more selectively in Europe but even here, for example in Britain, unemployment levels have been drastically reduced and capacity utilisation rates increased. Furthermore inflation rates are picking up, most noticeably in the commodity markets and for producer prices in the United States. Worldwide, there is clear evidence that the rate of inflation is tending to increase.

In this environment, it is quite clear to me that central bankers are primarily concerned with inflation and the possibility that economies will become overheated. As long as this fear of inflation continues to be justified, interest rates will continue to rise further. As a result of higher interest rates in the US, the dollar can be expected to strengthen, which will in turn exert pressure on interest rates in West Germany and Japan. Accordingly worldwide interest rates will tend to increase and there will be upward pressure on the US dollar which will cause other central banks to increase interest rates.

In this environment, the stock market is unlikely to perform in a satisfactory manner. Accordingly, in the short term, the prospects for stock markets and bond markets worldwide appear somewhat turbulent and lacking in direction. The present uncertainty regarding the future direction of economic policy in the United States is not at all to the liking of the financial markets. In fact the large rise in global stock markets dates from the Plaza meeting in September 1985 when markets really understood what policy makers were trying to accomplish and could make a clear bet on the success or failure of these policies.

Looking ahead, the present fear of inflation is exaggerated in my view. There is a very good chance that the world economy will emerge from the present imbalances to settle on a path of continued economic growth at a higher rate than before aided by faster productivity growth, an increase in the rate of investment and favourable demographic changes particularly in the United States. This assessment is also based on the expectation that the next US administration will make the required policy changes, particularly in the area of fiscal policy.

## Interpreting the Past as a Guide to the Future

My reading of the 1980s suggests that there are three important dates which will help us to organise our thinking both about the recent past and about where the world is going. First, the election of Ronald Reagan as the President of the United States and the prior appointment of Paul Volcker as the Chairman of the Federal Reserve Board. The next important date is the Plaza meeting in New York in September 1985. Finally, the third date of note is the stock market crash of October 1987. I will try to explain the interrelationships between these events and how an understanding of that past enables us to make some sense of where the world might be going in the future.

Looking back at twenty years of the inflation/unemployment spiral we note that every business upswing ended in accelerating inflation and forced a tightening of monetary policy which then led to a subsequent recession. If you plot the unemployment rates from trough to trough, you will find ever-increasing rates of unemployment and secular inflation.

Against this historical background, Reagan set as his objective to permanently lower both the rates of unemployment and inflation. Putting

it somewhat simply, he listened to the advice of a highly eminent economist, Professor Robert Mundell who said that the way to bring inflation down without increasing unemployment, as had been the case in the past, was to combine tight monetary policy with an expansionary fiscal policy that was largely based on tax cuts (the "Mundellian mix"). This is the supply side doctrine of voodoo economics.

There isn't time here to discuss the merits of this argument, but it is clear that the policy strategy adopted by Reagan produced one of the longest periods of expansion in the economic history of the United States. We are now in a regime of very low and declining rates of unemployment and a rate of inflation that is low by the standards of the 1970s. The policy has been a success and that is a lasting legacy of the Reagan era.

With the recovery of the US economy, we have also had a steady recovery in the OECD area as well. If we look at macroeconomic magnitudes, the real world appears very different from the more volatile financial markets. These real numbers indicate a period of steady economic growth from the early 1980s. In this respect, economic policy has been a resounding success, not only in the United States but elsewhere.

Of course, this is only one side of the coin. The strategy was unsound in the sense that it relied on deficits in the US federal budget and current account which were unsustainable. As the US government borrowed and interest rates increased as a result of tight monetary policy, capital was attracted to the United States and the dollar appreciated. In effect, the US was borrowing itself out of the recession of the early 1980s. It was clear that this could not continue for ever. Fred Bergsten and other economists started sounding the alarm early on, but they were not heard before the summer of 1985, when James Baker took over at the US Treasury from Donald Regan. He was persuaded that the US economy was heading into a crisis, a "hard landing" for the dollar and as a result the world economy would be thrust into another recession. A change in policy was required.

This brings me to my second important date; the historic Plaza meeting. The point of the Plaza meeting is that it marked a change in the direction of policy where the United States moved towards fiscal contraction and monetary expansion while other countries adopted more expansionary fiscal policies. The dollar was allowed to depreciate to restore equilibrium in the US balance of trade.

This change of policy did bring about a worldwide reduction in interest rates and a change in fiscal policy stance. The dollar was brought down in an orderly way in terms of the two main currencies. There was also "a bull market of a lifetime" in the stock exchanges, particularly in Japan.

However the problem was that there was excessive monetary stimulus and insufficient fiscal contraction. In the summer of 1987, it became evident that if the post – Plaza policy was continued, it would result in the resurgence of inflation in the US as the dollar was being forced down by expansionary monetary policy. Sooner or later, a tightening of monetary policy would be required.

In anticipation of such a change of policy, the bond markets collapsed in the summer of 1987. Long term interest rates increased much more markedly than short term rates. From this point, the collapse of stock markets was only a matter of time; it could have occurred well before October 1987.

## Peace and Prosperity

Let me conclude with a few remarks on the outlook for the 1990's. I do not expect a resurgence of inflation. Monetary tightening and the bursting of the stock market bubble will take care of that danger. For this reason alone, interest rates will be lower rather than higher in the 1990's. I also expect the fiscal deficit problems to disappear in the United States and elsewhere during the 1990s, in part because of the much discussed increase in social security funds, particularly in the United States.

Demographic trends will also be favourable and cause savings rates to increase, productivity to rise and unemployment rates to decline. The world economy will also be aided by political developments, the global spread of supply-side economics and most importantly, the move towards real peace and a reduction in armaments.

For these reasons, I expect the 1990's to be a decade of continued growth with low inflation and low interest rates, a decade of "peace with prosperity". After a period of turbulence and uncertainty, I expect both stock and bond prices to surge.

On this optimistic note, I would like to conclude.

# Integration of World Capital Markets – A View from Tokyo



*Yoshitoki Chino*

Chairman of Daiwa Securities,  
Keizai Doyukai

I would like today to present my view of the integration of world capital markets. I am not an academic and consequently my talk will not be conducted at an academic level. My views have instead been formed by my own actual experience in the market over a period of our decades. Since time is limited, I would like to confine my remarks to several issues concerned with the Tokyo stock market. I believe that this is important for three reasons. Firstly in terms of market characterisation, Tokyo is one of the largest in the world. Secondly, the Tokyo market is being deregulated. Thirdly this deregulation means that more foreign banks and security houses will enter the market thereby broadening opportunities for foreign investors. These developments will assist in the integration of the world financial market.

I wish to address three main points. The first concerns the reason for the recovery in the Japanese stock market after Black Monday. Secondly I will try to account for the high level of Japanese stock prices in terms of the price/earnings ratio (PER). These questions even arise when I hold lectures in Japan. Finally, if time permits, I would like to touch upon the integration of world capital markets.

Table 1 *Black Monday's Impact on the Major Stock Markets*

	(A) 1987 High		(B) Black Monday*		August 1988		
	Index	Date	Index	change from (A)	Index	change from (A)	change from (B)
Japan (Nikkei Stock Average)	26,646.43	Oct.14	21,910.08	▲17.8%	27,833.51	+ 4.5%	+27.0%
U.S.A (Dow Jones Industrial)	2,722.42	Aug.25	1,738.74	▲36.1%	2,004.37	▲26.4%	+15.3%
U.K. (FT 100)	1,926.2	Jul.16	1,439.2	▲25.3%	1,816.8	▲ 5.7%	+26.2%
West Germany (Commerz bank)	2,061.1	Aug.17	1,669.4	▲19.0%	1,474.6	▲28.5%	▲11.7%
France (Paris 50)	113.7	Mar.26	84.0	▲26.1%	121.6	+ 6.9%	+44.8%
Netherlands (Amsterdam General)	108.8	Aug.11	78.9	▲27.5%	96.3	▲11.4%	+22.1%
Italy (Banca Com. Ital.)	767.34	Apr.30	588.58	▲23.3%	528.95	▲31.1%	▲10.1%
Belgium (Brussels SE)	5,415.27	Aug.13	4,282.69	▲20.9%	4,909.10	▲ 9.3%	+14.6%
Australia (All Ordinaries)	2,305.9	Sep.21	1,549.2	▲32.8%	1,623.5	▲29.6%	+4.8%
Canada (Toronto Composite)	4,083.30	Aug.14	2,977.30	▲27.1%	3,285.20	▲19.5%	+10.3%
Hong Kong (Hang Seng Bank)	3,949.73	Oct.1	3,362.39	▲14.9%	2,600.93	▲34.1%	▲22.6%
Singapore (Strait Times Ind.)	1,505.40	Aug.26	961.50	▲36.1%	1,132.10	▲24.8%	+17.7%

\*) Oct. 19, 1987 or the next trading day, whichever the Index is lower.

Source: Calculated by "Daiwa Securities Research Institutes"

Let me first discuss the recovery in the Japanese stock market after Black Monday. The rate of decline from the 1987 high to the day immediately after the crash in the world major markets is shown in Table 1. Among the major countries, the rate of decline was lowest in Japan. The major explanation for this relatively modest fall was in my opinion the confidence of the Japanese people in both their stock mar-

ket and international economic and financial institutions. By the way, in Japan out of a population of 120 million, there are 20 million individual shareholders who represent the grassroots of Japanese capitalism. Five days after Black Monday, I was invited to discuss the stock market's problem on Japan's national television network (NHK). During the programme, I compared the events of Black Monday with the crash of 1929 when US stock prices fell by 47 per cent from the market high to the day following the crash. However it is important to remember that by the end of 1929, stock market prices had recovered to a level of 34 per cent below the previous market high. In other words, the average stock price had at that point fallen by only one third compared to the previous highest level. I would also like to remind you that at the time of the first oil price shock in 1973, there was also a collapse of world stock market prices.

Table 2 *The Change of the Major Stock Indices  
From 1973 High to 1974 Low*

	1973 high	1974 low	change
Japan (Nikkei Stouk Average)	5,359.74	3,355.13	▲37.4%
U.S.A. (Dow Jones Industrial)	1,051.70	577.60	▲45.1%
U.K. (FT 30)	509.50	150.00	▲70.6%
West Germany (Commerzbank)	795.30	520.00	▲34.6%

Source: Daiwa Securities Research Institute

A comparison of the change in major stock indices between the 1973 high and the 1974 low (See Table 2) with the margin of decline on the American market up to the end of 1929 indicates that the latter was not particularly large. A fall in the stock market by one third is neither a unique phenomenon nor should it necessarily lead to a world depression. However it should be recalled that as the world entered the 1930s, countries indulged in competitive interest rate cuts, tried to recall loans from agricultural countries principally in central Europe and Latin America, attempted to lower exchange rates and resorted to protectionist tariff measures. It was these measures that brought about the Depression. This experience teaches us one important lesson in relation to Black Monday. All of us should take Black Monday as a warning and discipline ourselves to prevent countries from resorting to independent and uncoordinated economic and financial policies. The importance of the maintenance of international cooperation as a means of averting a

world depression was the principal thrust of my statement on the NHK programme. In this respect, the Japanese market displayed a strong confidence in international cooperation. Immediately after the crash of October 20th. 1987, a large numbers of buy orders were placed by individual investors. Due to the immense number of small scale buy orders which led to a tremendous increase in the volume of transactions, many hours of overtime were worked by the staff of security companies on that evening. A normal pattern on the market is for corporate investors to move to a buy position at a time of falling stock prices. In the case of Japan after Black Monday, the aggressive purchases by individual investors served as the first shock absorber. Sustained by such a positive attitude on the part of individual investors, the Japanese stock market entered a steady recovery phase. The rising rate of stock indices in major markets from immediately after Black Monday to August this year are shown in Table 1. It should be noted that the stock market index reached a historical high *after* the stock exchange crash in countries such as Japan and Sweden. The Japanese market showed the best performance among the industrial nations. In the period following Black Monday – due to the time difference, it was actually Black Tuesday in the Japanese case – large volumes of Japanese stocks were sold by foreign investors in October and November. This was mainly due to a wish to realise profits and to cancel investments trusts. In the period January–April 1988, foreign investors returned to the Japanese stock market on a buying spree. This also attests to the high valuation that foreign investors give to the potential of the Japanese stock market. In the period from May 1988 to the present (August 1988) foreign investors have once again been selling Japanese stock. This selling has been primarily motivated by profit-taking since the performance of the Japanese market has been the best in the world since the October crash. Another factor underlying the large selling volume was the conversion of warrants and corporate bonds. These transactions – both purchases and sales – fundamentally affect the favourable performance of the Japanese stock market.

I would now wish to examine my second topic. The relative strength of the Japanese stock market may be put down to a number of different factors. The fundamental economic strength of the Japanese economy is obviously of central importance. In addition I would point to at least two other important factors: stable shareholding and the shift of individual assetholding into equities. If we examine a breakdown of share-

holdings by investors in Japanese stocks: commercial banks hold about 19 per cent, corporations about 30 per cent while insurance companies hold about 16 per cent of Japanese stocks. After the Second World War, the large industrial and financial conglomerates, the "zaibatsu", were disbanded by order of *General Hidegota*. The Japanese stock market was underdeveloped and individual investors frequently lacked the means to invest. Stocks were instead sold to banks and other corporations and as a result these institutions became major shareholders of many corporations. Since these major shareholders were comparatively stable shareholders, pressures to sell in the stock market as a whole did not build up beyond a certain point. I would emphasise that this is my interpretation of events and that there are of course many other explanations.

Another factor is that there has been a shift in the composition of individual financial assets from bank deposits to a variety of financial assets. I would consider this phenomena to represent a westernisation of individual financial assets in Japan.

Table 3 *Components of Individual Financial Assets*

Year end	1974	1977	1980	1983	1986	1987
						(%)
Cash and Deposits	64.9	63.7	63.5	60.4	55.9	55.2
Cash Currency	6.3	5.1	4.4	3.7	3.5	3.5
Demand Deposits	12.0	9.9	8.1	6.8	6.1	6.2
Time Deposits	46.6	48.7	51.1	49.9	46.2	45.3
Other Deposits	—	—	0.1	0.1	0.0	0.1
Trust	5.5	5.8	5.9	6.7	6.5	6.3
Insurance	12.0	12.2	13.0	14.2	16.3	17.5
Securities	16.3	17.0	16.8	18.3	21.1	20.1
Debt Securities	6.1	7.7	8.0	8.0	6.6	5.5
Stocks	8.8	7.7	7.3	7.9	10.9	9.9
Investment Trust	1.5	1.6	1.5	2.5	3.6	4.7
Others	1.3	1.3	0.8	0.5	0.2	0.1

Source: The Bank of Japan

Interest rate liberalisation in Japan has lagged behind that of the United States by 10–15 years. Before a start was made to the deregulation of individual financial assets, bank deposits accounted for roughly 65 per cent of individual asseholdings in Japan (Table 3). In contrast, the US deposit ratio has been a mere 35 per cent. An interest rate liberalization has nevertheless begun, starting with large bank deposits and gradually permeating down to other sectors. As a result, the preference of individual investors for higher interest rates has intensified the need to diversify out of bank deposits into other financial assets. In future, the ratio of bank deposits to other financial assets in Japan may gradually diminish to reach the American ratio of around 30 per cent. This reduction in the deposit ratio would represent a shift in personal asseholding from bank deposits to other financial assets including securities amounting to 175,000 billion yen (\$320 billion). Naturally this shift will not occur overnight. Statistics indicate that it took almost ten years to reduce the reliance on bank deposits from 65 per cent to 55 per cent. This slow but steady diversification of individual asseholdings will become a major factor in maintaining the Japanese stock market in the medium and long term future.

I would now like to briefly examine the price/earnings ratio (PER) in Japan. The average PER of Japanese equities is fairly high in comparison to other countries (See Table 4). In Japan the present PER is around 55 whereas the corresponding values for West Germany, UK and the USA fall within the range of 10–15. As the table indicates, the Japanese PER began to exceed 20 times after 1975 and the first oil crisis. In the previous decade, the Japanese PER had remained at a level of 15 following the recession in the mid 1960s. In the 1975 the PER surged to a level of 22 times having been only 15 times during the previous year. The view abroad that Japanese PER was high was undoubtedly strengthened in 1984 when it reached a level of 30 times. It is argued in some circles that the high Japanese PER is associated with speculative tendencies on the Japanese stock market. I do not find this argument to be true. Even the foreign exchange rate has changed vastly in the last three years. In February 1985 a US dollar was worth 265 yen. Today (August 1988) it is worth 132 yen. This change was not brought about by more speculation or speculators but by the economic fundamentals in two countries. The relatively high Japanese PER has been maintained for almost fifteen years and would consequently appear to be structurally in-built rather than the result of speculation.

Table 4 *PERs of the Major Stock Markets*

Year end	U.S.A.	U.K.	West Germany	France	Canada	Australia	Netherlands	Hong Kong	Singapore	Japan
1973	12.7	8.4	11.3	12.7	12.6	11.9	6.5	19.0	25.4	15.1
74	8.1	3.1	9.7	5.9	6.8	6.4	5.0	6.4	8.7	14.0
75	12.3	10.8	16.3	12.5	9.2	11.5	14.6	19.2	13.7	21.4
76	11.5	8.7	11.3	17.5	9.7	11.4	6.2	16.7	17.8	23.1
77	9.2	8.6	9.1	10.4	8.7	9.3	5.3	11.5	15.5	16.5
78	8.4	8.4	10.6	15.8	9.6	10.8	7.0	11.5	17.0	19.2
79	7.4	5.4	9.0	11.2	8.7	10.6	3.9	15.4	17.9	19.2
80	9.1	6.2	7.4	5.2	8.6	12.1	4.1	19.3	22.6	16.1
81	7.7	8.3	8.5	7.5	8.6	9.9	5.4	12.7	22.1	18.2
82	10.1	9.8	11.2	13.2	22.5	11.1	5.9	5.8	20.9	22.2
83	12.2	10.4	15.0	63.8	27.5	15.1	6.4	9.0	28.2	25.1
84	9.9	11.1	13.5	15.3	17.8	9.8	6.2	11.2	20.4	27.3
85	13.7	12.1	16.7	15.3	15.3	11.3	8.2	17.1	18.1	25.9
86	14.1	13.4	14.7	19.0	17.6	14.0	10.0	16.8	36.7	45.7
87	14.4	11.8	10.7	10.0	14.2	10.8	8.9	10.9	21.3	52.7

Source: Morgan Stanley Capital International Perspective

Table 5 *Real GNP & CPI*

	(Annual Rate: %)							
	1977	1982	87	88(E)	89(K)	87	88(E)	89(E)
	-81	-86						
Japan	4.8	3.7	4.9	5.1	4.4	0.5	0.7	1.8
U.S.A.	2.8	2.7	3.4	3.7	1.1	1.9	3.7	4.1
U.K.	0.6	2.9	4.4	3.1	2.1	4.1	4.3	5.1
Germany	2.3	1.7	1.7	2.5	1.9	0.3	1.2	1.7
France	2.5	1.7	2.2	2.2	2.0	3.3	2.7	3.4

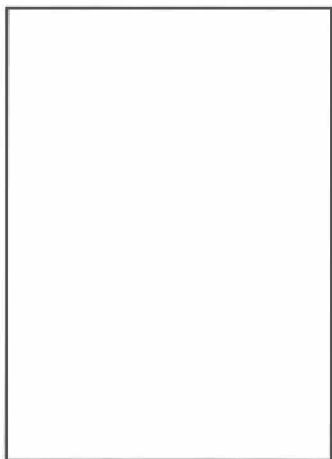
Source: Bank of Japan, Daiwa Securities Research Institute

Ultimately the high level of Japanese PER is perhaps best explained by the underlying strength of the Japanese economy. Real GNP grew by 3,7 per cent per annum in Japan during the last five years (Table 5). This contrasts with real GNP growth rates in the US, UK and West Germany averaging around 2,5 per cent – 2,7 per cent over the same period. In the medium and long term, Japan is expected to continued to enjoy low inflation and a stable economic growth rate of about 4 per cent. It could be the case that these strong economic fundamentals are reflected in the high Japanese PER. As an indicator PER may not be the only effective means of making international comparisons between equity prices. For example, the PER of Japanese automobile companies now stand at around 30 times compared with between 4–10 times for a major European automobile manufacturer. It would be difficult for a fund manager to choose between the two. Should the fund manager rely on the PER as the ultimate yardstick for assessing profitability? I am unable to answer that question.

I would now like to turn to the question of international integration of capital markets. This is a highly complex issue. There are very many forms of integration: investment methods, laws and regulations, taxation, investor protection, demarcation between banks and security houses etc. A further issue is the introduction and development of new investment instruments to major financial markets such as options and futures. This serves to bring the major markets closer and thus furthers the development of a global 24 hour trading system.

The integration of the capital market will continue in the future based on the awareness that Tokyo is one of the worlds three major markets with a reputation for stability and soundness. A continuing ability to solve problems on a case by case basis will allow Japan to participate in the global effort to seek unified standards and to nurture the world market.

# Challenges of Liberalization and Desintermediation: The Spanish Experience



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## Liberalization in Spain: a summary

Today, in Spain, there are still many restrictive regulations constraining the banking and capital markets. Most of these will have to be removed before January 1, 1993. But despite all that remains to be done, the Spanish banking system has come a long way in the past 25 years.

The first big push came in 1962, with the banking regulation law. During the remaining 60s and early 70s liberalization proceeded at a modest rate. The economic crisis of 1973–74 froze for a while the process of deregulation, as the instinctive reaction of the Spanish authorities to the crisis was defensive, but it could not last for long. Between late 1975 and 1981 the liberalization process proceeded briskly.

The aftermath of the second oil crisis again caused some setbacks. With the economy stagnating and mounting unemployment, financing the government's fiscal deficit became an overriding consideration for the authorities. Bank reserve requirements were lifted from 5,75 per cent to a maximum of 20 per cent of eligible liabilities, and so were

investments on government-approved securities (from 21 per cent to 25 per cent).

At the top of this movement towards greater government control, 45 per cent of bank liabilities were employed in assets chosen by the authorities.

Spain's accession to the European community and greater control of fiscal deficits gave a new impulse to the deregulation trend. Government-owned specialized development banks-for building, mortgage, industrial and agricultural credit, among others ceased to obtain cheap funds from private banks through compulsory investment ratios and turned to the market for funds. Interest rates for all assets and liabilities were freed, regardless of maturity or size, and deregulation of long-term capital movements started to be implemented according to the schedule negotiated in the accession treaty.

## Consequences of liberalization

Between the mid-1970s and now, the liberalization process in Spain has had several features worth noting. First of all, the process has only been partially led by demand; the authorities and, particularly, the Bank of Spain, have played a leading role in promoting it. Some sequential errors have been made. The freeing of branch openings before deregulation of interest rates led to the present situation, under which Spain has a bank branch every 1,200 inhabitants, roughly 2 or 3 times more than in other European countries.

Deregulation also had important consequences for the financial markets, both in terms of the kind of institutions providing financial services and in terms of instruments and markets. It took place in the midst of radical political change in the country, in the middle of a deep economic crisis and through one of the severest banking crisis wit in Western Europe since the Second World War.

Moreover, financial deregulation has been accompanied by increasing control on the part of the authorities. Its principal aims were to cut the cost of financial intermediation to ensure equality of opportunities and to strengthen Spanish institutions to face increasing foreign competition. On the other hand, the authorities have vastly increased their powers of inspection and control in order to re-inforce the security of the system, protect savers and investors and ensure proper monetary

control. At the same time the tax authorities have gained access to bank data to combat tax fraud. All in all, the system is now much stronger than before. It is also much more transparent; the annual reports of the Spanish banks are thought to be among the most complete in terms of information disclosure.

## Foreign banks

The presence of foreign banks has been one of the most visible results of deregulation. Before the law allowing foreign banks to open branches was passed in 1978, only 4 foreign banks were operating in Spain. Nowadays there are 43 and 7 more Spanish banks have passed under foreign control.

Table 1 *Foreign Banks in Spain*

	43+7	Spanish Banks under Foreign Control
Number of Foreign Banks		
Total Assets (Billion PTA)	2.511	
Total Credit (NET) (Billion PTA)	1.274	
Total Customer Deposits (Billion PTA)	368	
Branches in Spain	135	
Personnel in Spain	3.414	
	1979	1987
Market Share on Banking Assets	3%	15%
Market Share on Credit to the Public Sector		40%
Market Share on Foreign Currency Credit		30%
Market Share on Floating Rate Market		36%
Market Share on the Deposit Market		5%

Source: Consejo Superior Bancario

Their branches have managed to capture a considerable amount of business in Spain, and their success is one of the reasons why many financial service companies are thinking of entering the Spanish market by 1992. Their market share on banking assets rose from 3 per cent at the end of 1979 to 15 per cent now. Their control, however, is much higher in areas such as credit to the public sector, where they hold 40 per cent of the market, and in foreign currency credit, where they hold 30 per cent. Their share of the floating rate market – which they

introduced in Spain – is about 36 per cent. In contrast, their control of the deposit market is only around 5 per cent and they fund their operations mainly in the interbank market.

Foreign banks are, almost exclusively, wholesale and investment banking operations. Their penetration is high in sectors dominated by big companies – such as the utilities, automobile and engineering industries. They clearly beat their Spanish colleagues by a long shot in areas such as convertible debt, eurobond and eurocommercial paper, interest rate and currency swaps and mergers and acquisitions.

The seven foreign banks that purchased ailing Spanish banks have also done well. They have been specializing in particular areas of the retail market, such as mortgage credit and money market accounts. They have focused on the upper income section of the population and on the foreign residents market.

## Bank branching

Another highly visible result of deregulation has been the massive opening of bank branches after 1975. This was partly due to the temporal inconsistencies mentioned above, but also because the tax laws favoured heavy bank investments in computers and these unearthed a lot of surplus personnel who could not be fired because of the rigidity of the Spanish labour laws. After decades of repressing territorial expansion, the banks were let free to face regulated and widely divergent interest margins, and vast surplus labour which they could not redeploy. At the same time, large negative real interest rates put a very important premium on deposit gathering activities. Credit was very profitable. Opportunities were only limited by the availability of funding, as negative interest rates and the downturn in demand encouraged the corporate sector to borrow.

Table 2

### *Bank Branches in Spain*

	1975	1980	1985	1987
Banks	7.569	13.223	16.568	16.449
Savings Banks	6.365	8.197	10.853	11.711
	<u>13.934</u>	<u>21.420</u>	<u>27.421</u>	<u>28.160</u>

Source: Consejo Superior Bancario and Anuario

Under these circumstances, the pressure to expand the branch network was very strong indeed. Between 1975 and 1987 the number of domestic branches rose from 7,569 to 16,449, growing during the period at an average of 683 new branches per annum. The savings banks also expanded very rapidly. Their branches increased from 6,365 in 1975 to 11,711 in 1987. The 1988 regulation allowed savings banks to open branches freely outside their regions. And while some commercial banks have begun to rationalize their branch networks, others have still ambitious branch opening plans in their drawing boards.

The reason for this situation seems to be straightforward. Despite the undoubted increase in competition taking place in the Spanish banking market over the past decade, margins and profits are still among the highest in Europe.

Wholesale banking, as practised by most of the foreign banks and the specialized divisions of the biggest Spanish banks, has found profitable niches in the market without having to go into branching.

Out of the 105 branches which the foreign banks were authorised to open up to mid-1987, only a total of 60 had been opened. Moreover, only 3 foreign banks out of 36 had reached their maximum legal limit of 3 branches in the country.

Retail banking, however, has evolved in a diametrically opposite manner. Because of excess personnel and insuperable obstacles to labour mobility, the retail banking map of Spain has tended to move away from the European norm: bank networks are much wider, but branches are much smaller. In this, they have followed the rule of spreading fixed costs which in the case of Spain consists of labour costs/variable costs. Branch openings have also profited from what appears to be a constant of bank customer behaviour. All the surveys consistently show that most of the choices for banking with a certain bank are conditioned by proximity. In this situation, it makes sense to break up big branch networks into more numerous small branches.

## Deregulation: Imprint in profits and provisions

The deregulation process has also left its imprint on bank income statements. The most visible changes have taken place in the relative contributions of the main assets and liabilities to revenues and cost, as well as in the amounts devoted to provisions.

Table 3 *Relative Contribution of Main Assets & Liabilities to Revenues & Costs*  
(as % of average total assets)

	1975	1980		
Interest Income as % of ATA	7.83%	11.57%		
Interest Cost as % of ATA	4.07%	7.24%		
Interest Margin as % of ATA	3.76%	4.33%		
<b>Composition of Financial Earning &amp; Costs</b>				
	Late 70's	Early 80's		
Interest-Income from Credits	80/85%	60%		
Interest-Income from Interbank Operations	8%	33/34%		
Interest-Cost from Customer Deposits	74%	54%		
Interest-Cost from Interbank Operations	26%	46%		
Operating-Margin as % of ATA	(1985-86)	4.5%		
Operating-Cost as % of ATA	(1985-87)	2.7%	(personnel costs 2/3 of operating cost)	
	75	80-85	87	
Operating Profits as % of ATA	1.23%	1.63%	2.05%	
Provisions for Substandard credits and Losses on Securities, Pensions and other Needs as % of ATA	0.09%	0.9%	1.42%	
	75	80	85	87
Profits before Taxes as % of ATA	1.26%	0.75%	0.65%	0.94%

The deregulation changes in the composition of financial earnings and costs have been much more noticeable. The proportion earned from interest on credits fell from 80-85 per cent in the late 1970s to a little below 60 per cent in the early 1980s. Interest from interbank operations took practically all of the slack, moving up from some 8 per cent interest income at the beginning of the period to 33 per cent - 34 per cent at the end. The increase was shared by interest from the Bank of Spain and monetary assets, heavily influenced by the financing of the budget deficit, and by income from other liquid institutions operating in Spain. Interest paid to institutions operating from an outside base rose first up to 1985 and then declined following the profile of Spain's foreign indebtedness.

Trends in interest costs parallel developments in interest revenues, with those originated in traditional banking products gradually losing importance. Costs from customer deposits and other instruments, which represented some 74 per cent of interest costs at the beginning of the period, fell to some 54 per cent of the total at the end. Interbank costs rose *pari-passu* 26 per cent to 46 per cent of the total.

As a net result of the changes described, the operating margin has tended to stabilize around 4,5 per cent of ATA's in recent years. And the operating costs have tended to settle around 2,7 per cent of ATA in 1985–87, after rising sharply from 75 to 80.

Despite the increase in competition fostered by deregulation, operating profits have increased considerably in Spain in the past 17 years. They have risen from 1,23 of ATA in 1975 to 1,63 per cent in 1980 and 1985 and to 2,05 per cent in 1987. Under the guidance of the Bank of Spain, this increase in profits has largely been used to improve the solvency of the banks.

In this sense, the rather extraordinarily profitable years recently enjoyed by Spanish banks have been put to good use, improving solvency by the provision of substandard credits, losses in securities, pensions and other needs. Bank profits before corporation taxes declined from 1,26 per cent of ATA in 1975 to 0,75 per cent in 1980 and 0,65 per cent in 1985, to recover to 0,94 per cent of average total assets last year. The falling trend marks, however, this enormous effort made in order to strengthen the capital base and in order to strengthen the capital base and in general the health of banks' balance sheets.

## The main lessons

After all this, which are the main lessons of Spain's banking liberalization process?

- Although deregulation removes artificial lines between institutions, the system does not tend towards uniformity. Rather, a polarization process takes place by which middle-size institutions tend to disappear or to fall under the control of the big players.
- Specialization increases in many ways. The removal of intermediaries, which almost inevitably follows deregulation, creates opportunities for new niche players.

- Deregulation leads to desintermediation as non-banks are encouraged to compete freely with banks. The presence of a public sector deficit further encourages desintermediation because of the need to finance it at market conditions and avoiding bank's transformation costs.
- As the Spanish banking crisis clearly shows, it is both difficult and dangerous to deregulate in periods of economic crisis, inflation and sharply rising real interest rates. The process should be considerably less painful in times of relative financial stability, strong economic growth and expanding banking markets. The present circumstances are clearly more favourable for the deregulation required to meet the 1992 European deadline in a more painless way.

## The challenge of 1992

Faced with the challenge of 1992, the Spanish banking system displays today some strengths as well as some weaknesses. It has already absorbed well the shock of foreign competition, both at the retail and – more intensively – at the wholesale end of the market. The banks have also strengthened their balance sheets to a considerable extent. Present capital ratios exceed the Cooke Committee's targets by about 20 per cent; and by the end of 1988 country risk provisions would have reached at least 50 per cent for the Spanish bank.

The strength of the banks' income statements also suggest that pressure from new competition will tend to depress them in the future. However, this need not be as clear as it seems. Some liberalized banking markets – such as the British market – show margins considerably above the European average a long time after they were opened to the winds of competition.

Table 4 provides a comparison of the Spanish banks' income statements with the average for both French and German banks, all of them in proportion to average total assets (ATA) and for the year 1986. The greatest differences in those statements occur in the gross operating margin, where Spanish banks get 1,24 per cent moreover total assets, and in operating costs, where they spend 0,82 per cent more than their German and French colleagues.

The pessimistic reading of these figures is clear. As competition eliminates the differences in revenues, high and inflexible operating costs

Table 4 *Bank Income Statements, 1986*  
(as % of average total assets)

	Average French and German Banks	Spanish Banks	Diference
Interest Margin	2.59	3.73	-1.14
Other Operating Income	0.78	0.87	-0.09
Gross Operating Margin	3.37	4.61	-1.24
Operating Costs	2.18	3.00	-0.82
Operating Profits	1.19	1.61	-0.42
Provisions	0.60	0.79	-0.19
Profits before taxes	0.59	0.81	-0.22

*Source:*

reduce operating profits to below 0,4 per cent of average total assets. Since the needs to provision are high – almost 0,8 per cent of ATA – then profits disappear and a 0,4 per cent of ATA loss emerges.

The above discussion, however, is too mechanistic to be believed. More likely, the interest margin in Spain is unlikely to fall by the full differential, but only by a fraction. Greater efficiency could reduce operating costs to compensate, at least partially, for the loss in revenues. Moreover, the scope for increasing fee income and commissions appears to be quite high, both in Spain and in the two countries used as a reference. In 1986 French and German banks only received some 55 per cent of the income generated by the average American bank on commissions.

There is no doubt that competition will become tougher as a result of the single financial market. In wholesale banking, margins are already extremely thin and few more banks are likely to be attracted to Spain. In retail banking, the extensive branching network constitutes a formidable barrier to entry, and foreign competition is likely to concentrate, as it does now, in special niches such as the high net-worth individuals and the foreign resident market. Competition in retail banking is likely to be more successful in those retail services which do not need an ample branch network and which can be dispensed either through a plastic card or through direct marketing.

Investment banking is already heavily international in Spain. The

market has an enormous potential to develop, so there is, in my view, ample room for both foreign and domestic banks to increase their piece of the action. Recently, a number of new Spanish banks have been created. These institutions are likely to have to compete fiercely. But I think they will find an untapped market which is rapidly getting ready to use their services.

Competition is also likely to be very intense in other specialist areas of the financial market, such as mortgage credit, leasing and insurance. As in the case of investment banking, the Spanish market offers a high growth potential in these areas and there is room to accommodate newcomers, both domestic and foreign.

On the other hand, and quite uncharacteristically, Spanish Bankers, businessmen and the authorities are highly aware of the threats and opportunities of 1992. The recent moves towards bank mergers, and two crucial financial laws – the Securities Market's Bill and the Credit Institutions Discipline Bill – are good proof of the fact that the country is getting ready for the unified financial market.

## Mergers

In the past six months there have been two highly publicized merger agreements among banks in Spain. After a failed attempt to take over Banesto, Banco de Bilbao arranged for a friendly merger with Banco de Vizcaya. A few months later, Banesto and Banco Central announced their willingness to merge.

The Spanish authorities and the Bank of Spain had been leaning on the big seven Spanish banks to foster some mergers. The rationale is quite simple. They argue that big banks are more difficult to take over and they see mergers as a kind of vaccine against possible foreign poachers. The argument, evidently, works both ways. If after 1992, a European bank wished to buy a big share of the Spanish market, the existence of large post-merger banks would make the task easier, provided the poacher had enough funds for the purchase.

The merging banks themselves have justified their moves with a variety of reasons. They intend to get stronger in their home base to be able to face foreign competitors after 1992 and launch their own ventures in foreign markets. They will also be able to release a substantial amount of hidden assets under very favourable tax conditions.

Other leading Spanish banks are following different strategies. Hispano Americano is apparently looking for European alliances. Santander is already building up a retail base in several European countries through acquisitions. Popular has chosen to be domestic bank and do it alone.

Time will tell which strategies will lead to success. But one thing is clear. Spanish banks are thinking very hard about their future and 1992 will not come as a surprise.

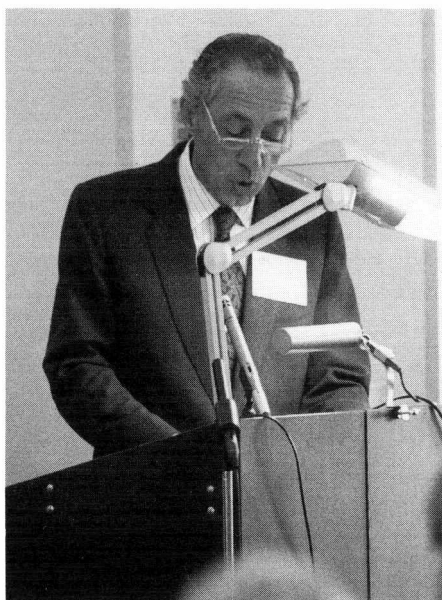
## Conclusion

The two crucial financial laws mentioned – the Securities Exchange Reform Bill and the Credit Institution's Discipline Bill – together with the reappraisal of strategic issues in all Spanish banks, give a flavour of the preparation going on in Spain to get the financial system ready for the challenges of 1992. Some of the costs of adjustment will be high, and the process is bound to create some discomfort. However, a great deal of the efficiency costs of excessive regulation have already been paid by the country. The banking crisis of the late 1970s – early 1980s provides ample good proof.

Since joining the European community in 1986, the Spanish economy has changed out of recognition. Activity has boomed and real investment has been increasing at two digit real rates. One million jobs have been created since then, and inflation has fallen to around 4 per cent. These conditions should make it easier to adopt the remaining liberalizing measures needed, and to give Spanish financial institutions a good chance to compete and prosper in the coming single European financial market.



*A quiet moment in the French dining room at Grand Hotel Saltsjöbaden: Mr Marcus Storch, President and CEO, AGA, and Chairman SNS Executive Board with Mr Kjell Nilsson, Vice President, Trelleborg.*



*Mr Alejandro Fernandez de Araoz, chairman Atlas Copco S.A., CE, presented the Spanish Experience of the integration of world capital markets.*

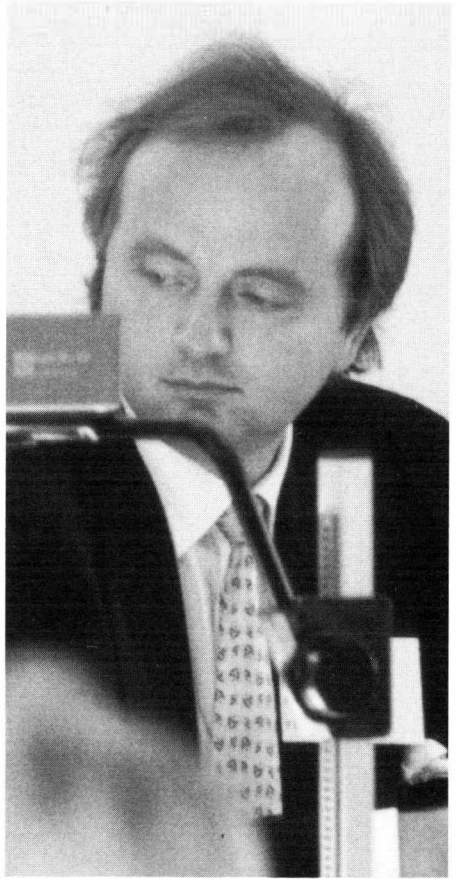


*Sir William Ryrie, Executive Vice President, IFC, Washington, gave his view on Private Capital Flows into Developing Countries.*



*Members of the Spanish delegation studying the programme.*

*Above Professor Pentti J.K. Kouri, New York University, and Chairman, Kouri Capital, talked of 'Current Trends and Warning Signs' with regard to the integration of world capital markets. Panel members below were Dr Tore Browaldh, SNS, Dr Werner Hundt, CEPES, and Mr Ray Gillham, CEDA.*





*His Majesty the King, honouring the Conference with his presence on August 31, is seated with Dr Hans Tson Söderström, Executive Director of SNS, and Mr Sven H Salén, Chairman, SNS Board of Trustees.*

*His Majesty King Carl XVI Gustaf chatting with delegates, from Keizai Doyukai, CEPES, CEDA and SNS.*





*Drottningholms Slottsteater*

JOSEPH HAYDN

# THE CREATION

Oratorio for soloists, choir and orchestra

given on the occasion of  
the SNS International Conference  
ONE GLOBAL MARKET  
in the presence of  
Their Majesties  
King Carl XVI Gustaf and Queen Silvia

August 31st 1988

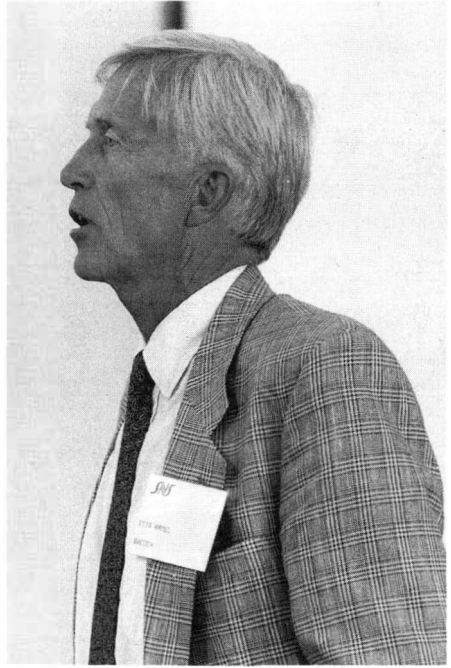
Dressrehearsal

*Cover of program for the festive performance given at the 18th century theatre at Drottningholm Palace on last evening of conference.*



*Top left Mr Ray Gillham, Honorary life member of CE-DA, with other members of the Australian delegation.*

*Left below Mr Ed B. Fitzgerald, Chairman and CEO, Northern Telecom Ltd, and former Chairman, CED Board of Trustees, with Prof Isaiah Frank.*

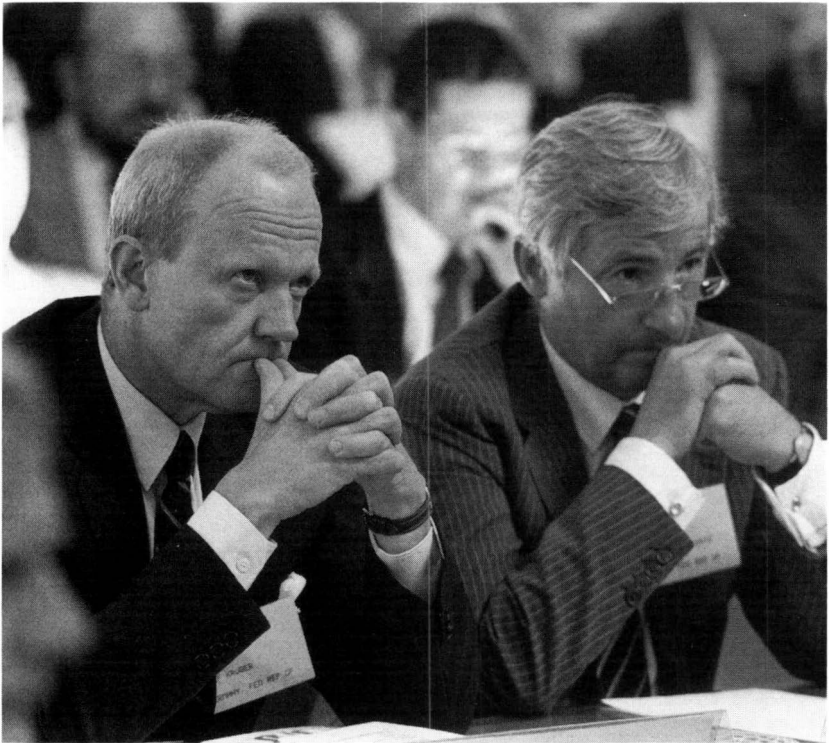


*Baron Stig Ramel, President of the Nobel Foundation, former Chairman, SNS Board of Trustees, and member of the Organizing Committee for the conference.*

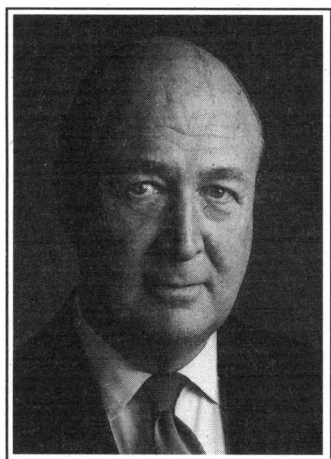
*Christian Allais, Director and Secretary to the Board of Trustees, Institut de l'Entreprise.*

*Right in picture H.E. the Japanese ambassador to Sweden Mr Y. Namura.*

*Dr Ralf Krüger, Bank für Gemeinwirtschaft, Frankfurt, CEPES, and Dr Hans-Joachim Nimtz, Executive Director, CEPES.*



## Comments by a panel of Trustees



*Dr Tore Browaldh*

Former Chairman, Handelsbanken  
and Volvo  
SNS

Your majesty, ladies and gentlemen. Already in day nursery, a banker is taught that to be pessimistic and sceptical is very becoming, while a banker who is an optimist, is a rather suspect figure. Hence it is necessary for me to write down in the margin of the plans for the global capital market, a number of question marks. I will not, however, put on my doomsday cap. First of all, it is interesting to note that, only 70 of the 300 directives that have been pointed out by the common market as important areas for liberalization of the markets in Europe, have been adopted – but not yet implemented. We have to remember that those directives do not disturb any of the strong vested interests, which will have to be dealt with later on. Consequently, I am, as probably most of you are, a bit sceptical of the time table. If the implementation will take another 3–4 years, I think that is a great achievement.

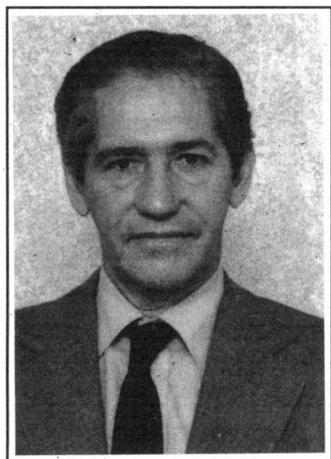
Secondly, I am also a bit sceptical, because I see the political and national element cropping up in discussions of the removal of all the restrictions within the common market. We have to remember that agreements on deregulation are not the same as implementation. I believe that the grounds for conflict between the countries will appear when the common market starts with the remaining 230 directives. We have already seen that Mrs Thatcher has expressed certain opposition

to some of the measures that have been discussed. Take for instance the liberalization of short-term capital movements. A removal of all national barriers would mean that any individual or corporate entity, could move all their deposits from one bank, hopefully not my own, nor mr Palmstiernas, but from other banks in Sweden, to Japan, to Italy, to the United States. If you deposit this money in the first place in the United Kingdom, you could then move them over to the US or Japan. The same thing could happen in relation to money market instruments. I have a feeling that many, many years will elapse before they will agree to the complete freedom of these movements of deposits and money market instruments. No government wishes to see savings, which are usually too small – with the exception of Japan of course – leave their own country to be invested elsewhere. In this respect it is rather significant that when the 12 finance ministers met in June this year to discuss the problem of liberalization of short-term money movements, objections were immediately raised, saying that "after all there had to be certain safeguards, after all harmonization etc, is necessary". This shows that no government is willing to give their citizens the right to vote against their bad economic policies, by allowing them to move deposits and money market instruments abroad.

Let me then take the third aspect of my pessimistic question marks. (They are only pessimistic in the short run, but in the long run we are all dead, as Keynes once said.) Nationalism is very strong in Europe, and in the world. It is interesting to compare, as Peter Drucker said, 1913 with today, where you have two Germanies, two Koreas, three Indias, etc, etc., I believe that nationalism is a particularly acute issue when it comes to take-overs and ownership. The Benedetti Circus in Belgium is, I think, a very significant and interesting example of the psychological shock that occurs when a foreigner tries to get hold of a large company that is considered a flagship in that particular country. I think it is a pity that we have these reactions, but we have to remember, that nationalism today is probably, in spite of the common market etc, stronger than it was earlier in the century. A lot of interesting devices have been used recently to stop the transferring of major companies, from one country to another. I will take a few examples. Unilever, where I sat on the board for twelve years, has 3000 shares owned by the two chairmen. The two owners of those shares are the only ones who can propose candidates for the board of directors, which is a very useful device in my opinion. Another example is that companies like

Philips and Shell are controlled by large foundations together with the respective managements. The large German banks own sizeable parts of the share capital of the large German companies and the same applies to Switzerland. Here another interesting method is employed: in many by-laws they have put in a regulation which stipulates that only shares that are registered can vote at the shareholders meeting. It is the board of directors who decides which shares can be registered! In Sweden we have other interesting methods, for instance cross-ownership. We also have companies where a small minority who owns shares that have one vote can out-vote the majority of shares that have only 1/1000 of a vote. Hence it would appear that we have to understand that the future of the global capital market has many hurdles to jump over before we can talk about free capital movements. This does not mean that we should not work for it, but I think it is necessary to point out these particular problems.

Let me end by repeating that governments, people and businessmen are very very nationalistic. And I am reminded of what Churchill once said of Herbert Morrison. He said that "Herbert Morrison looks at international issues through the wrong end of a municipal sewage pipe".



*Ray Gillham*

Honorary Life member CEDA

Your Majesty, Ladies and Gentlemen.

I would like to take this opportunity to make some comments about two aspects of the subjects under discussion.

Firstly, in his excellent paper, Mr Fernandes de Aroz described the changes being made in Spain which should give the Spanish financial institutions the opportunity to prosper in the coming single European financial market. I would like to quote some comments made in a recent CEDA publication by Professor Drake and CEDA's Director of Research, Dr Nieuwenhuysen which describe a parallel situation in Australia. During the mid-1980's the Australian financial sector was deregulated and the public at large has been the main beneficiary. The real rewards for lending have risen while the costs of borrowing have fallen. For industry in general, restructuring has been facilitated by financial resources flowing more easily to the productive sector. So far as economic growth is concerned, deregulated competition in the financial sector has, first, enlarged output and employment in the sector itself; second, it has generally increased the supply of finance to industry and commerce and eased access to it, thus encouraging investment generally. It can be seen, therefore, that financial deregulation in Australia, as in Spain, has been of considerable benefit.

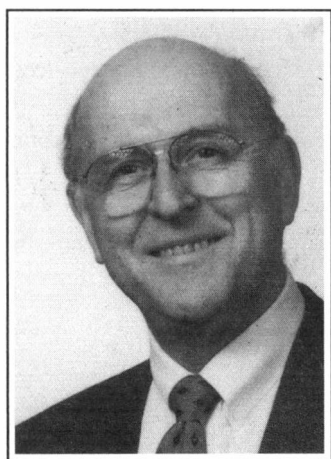
Secondly, I would like to make some comments about the movement of capital. Yesterday Professor Frank said that the ability of the US to run large budget deficits for years without crowding out private consumption or investment reflects the global integration of financial markets that has enabled the US temporarily to draw upon the savings of others. He said that today the pool of savings is worldwide and intermediaries that mobilize those savings for use by borrowers are not confined to national boundaries.

I would comment that the system clearly worked very well in this case, however this and the implications of the title of this session might suggest that a free flow of capital in accordance with supply and demand will always be the case if the agencies of capital are freed up. As Mr Chino said, it is a complex issue – there are many forms of integration. I am neither a banker nor an economist and perhaps it is because of this that I see some difficulties at times in drawing too close a parallel between the movement of capital and the movement of goods in what is called "One Global Market".

The apparent differences between them are exemplified by the peculiar constraints which can be applied (and in some notable cases such as those loans which may have contributed to massive third-world debt, perhaps should have been applied) to the flow of capital. They suggest that there are (or in some cases, perhaps, should be) constraints to the

capital trade, that it can be an irregular business, conditions applying in one area being different from those that may apply in another.

I might be trespassing on ground to be covered in the next paper when I suggest that restrictions that might be imposed on foreign capital (for example on the ownership of enterprises and the requirements for joint ventures) can be significant obstacles for investors. Host governments can encounter political difficulties when there are emotional objections to foreign ownership of land and property. Nevertheless these considerations and potential difficulties are real and perhaps place capital in a different category when it comes to globalization.



*Werner Hundt*  
General Manager Dresdner  
Bank AG  
CEPES

Your Majesty, ladies and gentlemen.

I am not a research professor, I am a practical banker, and the nuts and bolts of daily banking are my daily chore, so I want to leave it to others to challenge Mr Kouri on his predictions on the world's financial future. I wonder whether you are as horrified as I am by his worldwide casino idea.

As I understand it, market fluctuations are not only based on economic fundamentals but instead reflect the hopes, fears and expectations for the future, whether these are justified or unjustified. What happened in October 1987, however, points to certain dangers that can emanate from stock exchanges. The infamous "Black Monday" raised

doubts, whether the financial/capital markets could lose touch with reality and develop an uncontrollable momentum of their own. There were over-optimistic assumptions regarding the tradeability of stock, short-comings in the management of risk and illusions of liquidity in certain markets, all of which combined caused a wave of selling and an erosion of capital. Now, all the market participants are wiser and corrective measures have been taken or are being taken. The same mistakes, I suppose, will not be made again. We will surely find others.

I wish instead to confine my remarks to the speech given by Mr Araoz, who has informed us about the Spanish experience of liberalization of the financial system. I happen to represent a bank that has "invaded" this market. In my view all is about increased competition. First you enter a promising market, as we did in Spain and in view of the very good margins you do well for a number of years. Indeed after a period of 6–7 years in Spain and given the prices of financial services, the good results are still with us today.

Prices such as 196 percent higher for foreign exchange services compared with the average of the four lowest European countries, 118 percent higher for mortgages, 59 percent higher for letters of credit, etc, places Spain at the top of the league as far as remuneration of banking services is concerned. However, such a market learns its lessons rapidly.

The handicaps for a newcomer from abroad are:

With only one or two branches allowed in such a country, the foreign investor has not, of course, sufficient penetration of the market place.

You also have restrictions on your funding.

How are you going to get a bigger market share? This will presumably require acquisitions to be made.

Then, you run into headaches on a large scale – management differences in mentality, different electronic systems etc. This experience in Spain can be repeated in many markets. If you invest in a country with a less developed banking system such as Spain in those days, you may get a permanent foot-hold there. However, case-studies of banks that have tried their luck in Stockholm seem a little less attractive to say the least.

So then how does a bank plan for 1992?

Nobody knows for sure, although we know what 400 financial institutions think:

It will on balance hurt the smaller banks.

Some of them think that 2/3 of their profits will originate from their international activities.

40 percent want to open new outlets in Europe.

60 percent look for cooperation with non-banking distribution networks.

Nobody seems to think that joining forces with strong, foreign institutions, which are currently competitors, will open access to that foreign market.

1/3 believe in direct marketing.

The main target group is the medium sized company, and not the multinationals.

Euro-wide coverage by branch network is considered too costly by most. Everybody digging in everybody else's garden seems to be illogical, but will probably happen before the shrinking process will start.

What options do we have?

We either stay regional, with a risk of erosion of our client base, because other invaders are around.

We go for direct marketing as this world gets ever more electronically penetrable, (armchair banking). One could reach, at lower cost, a sufficiently large market. On the other hand there is a doubt whether a rich investor at the Cote d'Azur will deal with a banker in Milano.

There are cooperations and joint ventures between banks. This is in principle the most intelligent way, but there is a hitch: We have all tried, but most have failed, due to too much talking and to little action.

Expand branch banking, but with almost 5000 banks in Germany, who needs more? The cost, the different mentality and the lack of a deposit base are the problems.

Loan or business production offices, or representatives are helpful although they are not competitive against established branches of other banks.

Summing up, as far as I am concerned, you cannot be everything to everybody. Know your particular strengths and market them well. Follow not a "menu" – but an "à la carte"-approach. Keep on your toes, your skill in a particular product will not last for ever. Others will catch up.

# International Capital Markets — Private Capital Flows into Developing Countries



*Sir William Ryrie*  
Executive Vice President,  
International Finance Corporation

I want to talk today about the role which international markets can play in channeling private resources to developing countries. Some very interesting changes are taking place in those markets. We are beginning to see an integration of a few of the more advanced LDC markets, into the international financial market place. One important question for the next decade or so, will be whether the global markets can provide a much larger part of the funds which those developing countries need for growth.

The success or failure of the development effort in the developing countries in the coming years, is going to depend to a considerable extent on how far we succeed in harnessing the private sector, both in the developing countries, and in the developed countries. If we are to succeed, companies in the developing countries must be increasingly linked to world capital markets. The need for capital there is obvious, but I think we can also show that this need coincides with opportunities for investors to make profitable investments, if they are properly

selected and planned.

Before coming to the capital markets, let me say a word or two about how the world has been doing in encouraging private capital flows generally to developing countries. These flows take many forms. Apart from official bilateral and multilateral finance, which comes from governments and international institutions, we have commercial bank lending export credits, direct foreign investment and we have portfolio investment. The statistics on all these flows in this decade have been really rather sobering. These are mainly OECD figures.

If we look at the total net resource flow, official and private, funding of this kind for LDCs fell from US\$ 139 billion in 1981, to only \$82 billion in 1986. Official development finance rose, but very modestly, and private flows fell sharply between those years from \$71 billion to \$30 billion. Of course, the large part of that reflects the collapse in commercial bank lending after 1982. But export credit finance also fell, and what is perhaps less well known is that private direct investment remained more or less stagnant, in fact fell very slightly, from about \$13.5 to about \$12.5 billion.

If we make a comparison with period 20 to 25 years ago, in the late 60s, private direct investment was then providing about 25 percent of the overall flow of capital developing countries. It is now providing only about 10 percent of a total flow reduced in real terms. This is disappointing, because it is quite clear that developing countries, even those which have been rather successful in mobilizing their domestic savings, are going to need external capital if they are to reach self-sustaining growth.

I think we can also assume that the budgetary problems of major developed countries are going to make it unlikely that official capital flow will grow very fast. Commercial bank lending which has fallen off very sharply, is not going to rise strongly. Only Asia is now receiving significant amounts of new commercial bank lending. In any case, in my opinion, commercial bank lending in the form in which we mostly see it, which is to say sovereign lending to governments, is not the form of capital that developing countries need most. Because it goes to governments, that lending is not usually associated closely with conditions over the use of the money. On the other hand, direct foreign investment, equity investment, where the risk which the investor takes is directly associated with the use of the money, with the success or failure of an enterprise, seems to me in principle to create the circumst-

ances in which capital is best used. However, we have not been very successful in stimulating that kind of flow. I think the signs are now that many developing countries are increasingly aware of the value and importance of attracting this kind of investment.

There is certainly a lot more realism about the developing world than there was 10 years ago. The last 10 years have been quite extraordinarily though for most developing countries for obvious reasons. Under the pressure of the World Bank and the IMF and indeed just the lash of hard reality, many of them have adjusted their policies substantially, cut back expenditures and the public sector and are giving market forces more scope. I think one can see a gradual trend towards more welcome for the foreign investor. We in IFC have been trying to encourage this process. We have an advisory service that is called FIAS, the Foreign Investment Advisory Service and it is interesting to note that the demand for its services has been really growing quite strongly in the last year or two. There is an interest in finding ways of attracting more foreign investment, although as everyone knows this is a sensitive subject politically in countries of all kinds, developed countries as well as developing.

However, I believe that we are at a new stage in the development of world financial markets. We have seen, as people have pointed out this morning and often before, a process of internationalization of financial markets. The advances in communications technology and the amazing outburst of financial innovation, especially in the early part of the 1980s, have created a situation in which the major markets, New York, Tokyo, London are in effect one single market. It is not quite correct to call this a global market, if you allow the glibble, because many parts of the globe are not yet involved in it, but that too is changing in an interesting way.

While these changes have been taking place in international markets, there have been other trends at work in the developing countries. It is now much more widely recognized, that an under-developed country cannot progress significantly, unless it develops its own capital market. It needs an efficient mechanism for accumulating savings and allocating them to productive domestic use. By far the most efficient mechanisms are those which rely on market principles, rather than on government control and direction which has been far too prevalent in most developing countries in the past. The strategies being evolved by a great number of developing countries now include plans for building up such markets.

As part of this, one of the most interesting trends in the last 10 or 15 years, has been the emergence of equity markets in some developing countries. That in turn creates the potential for a flow of capital in a different form, in the form of portfolio investment, which is beginning to become important. This may come as a surprise to many people around the world, but not to us in IFC, because we have been working on this for years in a number of ways. Let me just say a word about what we have been doing.

One of our functions is to give advice and help to the governments in the developments of these markets in modernizing their securities markets. This is a wide ranging process, including, for example, the development of a treasury bill market in Turkey, the establishment of organized stock exchanges and supervisory agencies for them, in countries like South Korea and Jordan, and recently the computerization of stock exchanges in India and Pakistan. We also do a lot to help those markets to work by creating and investing in financial institutions to act as players in the domestic markets – a great variety of financial firms, security dealers, merchant banks, leasing companies, venture capital companies, housing finance companies and the like.

While doing this, we have evolved over a good many years a data base, a computerized data base on equity bond and money markets in 19 developing countries known as the emerging markets data base. This provides information on stocks in those countries, in most cases going back to 1975, including a price index and a total returns index for each market. This information has been disseminated to member countries and international investors and interested groups. We are glad to let anyone here who is interested to know how we can supply it to you. IFC's data have played a role in interesting investors, especially major institutional investors, in the possibility of portfolio investment in some of those countries.

Let me give you just few facts about some of those markets. There are, we estimate, 19 significant markets which have a total capitalisation of \$188 billion compared to \$55 billion in 1982. The five largest of these – Taiwan, South Korea, India, Malaysia and Brazil – range in size from \$15 billion to \$49 billion in terms of market capitalisation. Although these figures are obviously much smaller than the markets of New York, Tokyo or London, they do compare with a number of medium-sized European markets.

The 19 emerging markets have about 8,500 stocks listed on them

and there are more than 15 of them with around 100 listed companies, which is similar in range to the listings of a number of European markets. India is an odd case, where they have over 5,000 companies listed but which is larger even than the UK and Japan, but a large number of them are small and not much traded. When it comes to actively traded stocks, we estimate at the end of 1987, that there were 194 companies in those markets with a market capitalisation in excess of \$50 million.

As for performance, the record is really quite remarkable and not as well known as it deserves to be. An average portfolio of investments in those markets over the last 10 or 12 years would have outperformed the Dow Jones in dollar terms. Five of the markets we have tracked, have outperformed both the US market and the more demanding Morgan Stanley Capital International World Index. Even 1987 was a year in which many of those markets stood up very well, and most of them outperformed the American market in that year. A number of them, South Korea, Philippines, India, Pakistan, Argentina, Jordan, Nigeria and Zimbabwe, were more or less immune to the October crash. Taiwan, South Korea and Thailand outperformed even Japan, even after allowing for the appreciation of the Yen. South Korea was one of the few markets in the world to end the year higher than it stood on Black Monday.

Now, as knowledge of these facts has been spreading over some time, we in IFC have been looking for ways of encouraging a flow of capital, of portfolio investment into those markets. The main technique has been country-specific portfolio funds. The prototype was the Korea Fund of 1984 launched partly by IFC. Some of you may know that it has been a spectacular success, the initial offering price was 12 dollars in August 1984 and has recently been trading in New York at 85 dollars. We have also initiated a number of other funds in other countries, such as Thailand, Malaysia and Brazil and a worldwide Emerging Markets Growth Fund which can be invested in any developing country. This has been followed by a second one of the same kind, a twin, called The Emerging Markets Investment Fund, which was aimed specifically at Japanese investors. These have all been particularly successful.

The fund technique is valuable. Remember that over a quarter of a century ago, a newly emerging market made its debut on the international scene through the Japan Fund. Nowadays we estimate that about

\$1.5 billion has been invested by portfolio investors in over 40 funds. Funds have become rather fashionable in Brazil, South Korea, Taiwan, Malaysia, Mexico, Thailand and India. It is anybody's guess, but I think it is quite possible that the amounts could reach an annual flow of between 500 million and a billion dollars annually in the early 1990s. To put that figure in some kind of context, it would be substantially less than 1/10 of 1 percent of the two trillion dollars held by pension funds and other institutional investors in the industrialized world. If the amount were to reach even 1 percent of that total, it would be a formidable amount and would be more than commercial banks have lent to developing countries as a whole in the last two years. So the potential there, from the point of view of developing countries, is quite interesting.

As an aside let me add that as an outgrowth of this kind of activity, a new kind of fund is coming into existence, namely debt/equity conversion funds. I believe that the debt/equity conversion process has great value. Of course there are certain questions and problems about the process, but on the whole it has great value for developing countries. We have been trying to promote it by setting up debt/equity conversion funds. So far there are three in operation: Chile, Philippines and Brazil. Once the debt equity conversion process is complete, these funds become in effect mutual funds, rather like the portfolio funds I have described. Something like two billion dollars have probably been converted from debt into equity in the developing countries so far. There is no reason, we think, why similar sum should not be achieved in the next few years through the fund process.

There is still another way in which developing countries may be able to gain from developing links with international capital markets. This is through issues by individual corporations in those countries to raise capital on the international capital markets. On some exchanges there are a number of shares of developing country corporations already listed. For example a number of Malaysian shares are listed in London, some Mexican and Philippine stocks in New York, Papua New Guinea stocks in Australia. But there is scope for more of the stronger companies, in some developing countries, to raise capital by issuing stock or other securities on major markets. Korea offers some obvious possibilities, but there are certainly others, in Asia, Latin America and the Middle East.

Some of these are very good competitive companies, sometimes lead-

ers in their own industrial fields. Competitive pressures bring them to the point in which they really cannot raise capital on their own limited domestic markets on terms that are sufficiently attractive for them. So I believe we are going to see a process whereby, whether they like it or not, and whether their governments are reluctant or not, in the long run they will be forced to go international in raising capital. Some governments are still a bit reluctant about this, and it will take time, but we would help to play some part in introducing underwriting, sometimes guaranteeing issues of various kinds on international markets for such companies.

All this has been aided, of course, in the minds of institutional investors by a trend towards international diversification, mostly in investments within the industrial world, with the developing world on the fringe. But there has been enough interest in the developing world as a marginal diversification, to create great potential. I think there are three things driving institutional investors in that direction. First there are the attractive returns, which I was describing earlier. The record is quite impressive. Secondly, those attractive returns partly reflect the fact that you start by buying stocks at very good values. Good values can be found in many of the emerging markets, because they have not been discovered by the international investors. As of last year, the price/earnings, and price to book ratios of emerging markets, were significantly lower than for developed markets.

There are various reasons for this. One is that modern investment techniques and securities analysis are not used on a wide scale in those markets. More basically, these markets are less liquid, so that prices have not been bid up to the levels that one finds in the US and Europe, and certainly not like those of Japan. As I said earlier, those countries, nevertheless, contain a few of the most efficient companies in the world.

And the third factor which interests major investors is diversification. The record shows that the fluctuations in those markets generally go more or less out of phase with fluctuations in the major markets, an attractive feature from the point of view of an investor looking for diversification.

Now you may say that I am giving you a completely upbeat picture. There is of course a downside as well, things that should make investors in those markets cautious. One has been the difficulty of getting information and I think we are putting that right. It is often said that

these markets are small, lacking liquidity, that there is not sufficient disclosure, too many restrictions on foreign investors, and political risks.

These problems do all exist, but I think they are not as serious as many people imagine. It is true that on the whole emerging markets are not very liquid, in the sense that there are large blocks of stock which cannot be bought and sold without major price movements. But this is not peculiar to emerging markets. It has been estimated that only about a hundred company stocks outside the United States can be regarded as fully liquid in that sense. Disclosure is certainly a question. In most emerging markets, practices are not the same as they are in the United States but we find the disclosure norms are often surprisingly good when compared with many of the markets in Europe and Japan. A sizeable number of the companies quoted in our emerging markets data base are audited by the "big eight" accounting firms. Investor protection certainly needs to be improved in most countries, but many of those countries have now got securities legislation modelled on US or British law, but the enforcement of investor protection and sanctions against insider trading, one has to say, are sometimes not as strict as in developed countries.

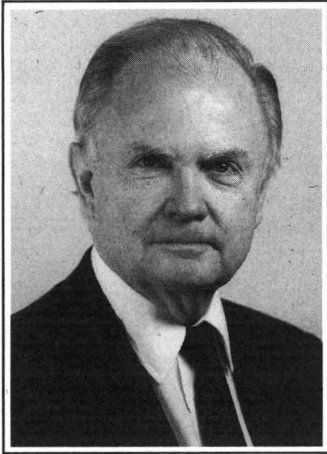
There is the question of investment restrictions, including tax barriers, and I absolutely conceive that further improvement and liberalization is needed. But they are not really any longer a serious reason for writing off these markets and not looking into them. The trend in all the markets is very clearly towards liberalization and internationalization. To give you a few examples: in Malaysia, Kenya, the Philippines, and Jordan, the markets are more or less completely open with hardly any restrictions on new entry, or on the repatriation of capital or dividends. Thailand, Chile and Argentina allow fairly easy access, but impose some registration and minimum length of investment restrictions. Others, like Brazil, India, Taiwan and Korea are – for the time being – accessible only through fund vehicles, not by the purchase of individual stocks. In Mexico there is a fund, but certain individual shares – not all – can be purchased directly by foreigners. As for taxes, in most of these countries, withholding taxes are close to the international average, or likely to be brought into line with them very soon. Nevertheless, there are exceptions. In Chile and Malaysia, heavy withholding taxes on dividends have recently replaced corporate income tax, which is something of a discouragement.

There is finally the question of political and exchange risks. Both

political and exchange risks in many industrial countries are certainly there. But I think it is not unfair to add that if you make an investment in a major international company with worldwide activities, like Mitsui, or Volvo, or Union Carbide, you are taking to some extent a similar risk, because a part of the return of that company will depend on activities in those countries. That is not altogether different from an institutional investor diversifying a small part of his holdings into those countries.

What we call the developing world covers a wide range of countries which are at very different stages, some much more advanced than others. As countries progress and build up their securities market, the possibility is opening up of linking those markets to the great markets of the world. That is what we have been seeing. For the reasons I have given, the performance of stocks in those markets, in spite of their imperfections, has been such as to attract and increasing flow of investment. I believe we are just at the beginning of a process of expansion here. Korea is at a stage not unlike the stage Japan was in the early 1960s, and heading in the same direction. Others are not so very far behind. Those who are starting on this road now have advantages which the Japanese did not have in the 1960s, namely the enormously greater efficiency of the international markets in terms of communications and flexibility of techniques. All this creates the possibility of rapid advance. We still have a task to convince some governments in developing countries, of the gains that they could get from encouraging more investments of this kind. I am rather optimistic that we in IFC will be successful in the pursuit of that goal.

# Comments by a Panel of Trustees

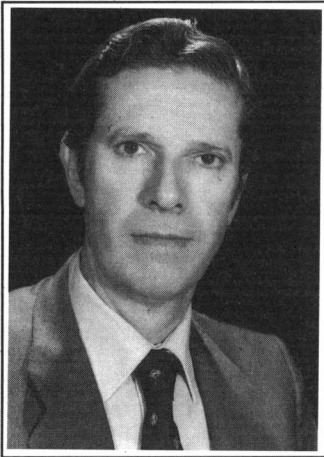


*Roderick M Hills*

Managing Director and Chairman,  
Manchester Group Ltd.  
CED

Your Majesty, Sir William, thank you for those thoughtful comments. I have only five very brief, very obvious, and hopefully non-controversial observations. First, the lack of capital in so much of the developed world exists because there is a corresponding lack of good investment opportunities. Opportunities that would be there, but for the policies of government that stand in the way. In some of those countries, surely the Phillipines, Mexico, maybe Argentina and Brazil, the money that the citizens of those countries have taken out exceeds the debt they left behind. Surely if those citizens will not put their capital in their country, because of the policies of their government, we should not rush to fill the gap. Surely we should not do – as we have so often in the past – throw development bank capital, and the capital of our governments treasuries, at the problem. This is, of course, a fairly naked argument for more privatisation and less government. When we can as a community, accept the notion that there should be less government and more privatisation, we may also be able to attack the common curse of corruption that has swamped the ambitions of so many developing countries. Not just the corruption of private or public officials that exists everywhere, but the corruption of the market place, that exacerbates the temptation to be bribed. Second, we really must be far more

aggressive in dealing with the debt of those countries – a debt that has often been created by developed countries who give money to countries that have no idea of what to do with the debt, and money that has been simply squandered. I do not at all suggest a common universal plan to forgive debt or to deal with it on a broad basis, merely a careful, specific effort to remove those policies and practices that obstruct the use of more practical, innovative, and market-sensitive ideas to reduce the debt, accounting and tax policies that too often prevent the writing off of debts, that should be written off. Moreover, the undue – and I emphasize the word undue – fear in some places, particularly our country, that bank failures will unduly harm the economy, if they face up to the fact that their debt is not going to be paid back... Today, most of our opportunities, at least more of our opportunities in the developing world, are directed to the opening and the expansion of their markets for our products, for our services. They are far less based upon the taking of undeveloped resources, particularly the undeveloped resources of uneducated and cheap labour. We must know, therefore, that the tensions that try us, that interfere with these meetings, will not be eased sufficiently until we develop those new markets. Some day the 300 million people of the six Asiatic countries, will have a market which will surely rival that of the United States, and the EEC, as they begin to develop it. The faster that happens, the quicker we can all protect our own growth rates. Fourth, as we compete for those new markets, we should understand that our policies, and our practices, whether they be of our companies or our governments, will work far better if they anticipate and adjust to the emerging, changing, and far more competitive realities of the world economy, and be based upon the narrow – and sometimes shortsighted – policies of our national economies. Finally, it seems to me that we are far too careless in using the term "developing countries", to mask the enormous differences that distinguish each of them from all the others. Asia from Latin America, Africa from China, perhaps even Nigeria from Ghana. When we construct the policies and practices to the unique issues of each of those countries, we might do well to remember the answer that our humorous Will Rogers once gave to the question: how do you choose vacation places? He said: Well, I try to remember that no place turns out to quite as good – or quite as bad – as it was supposed to be.

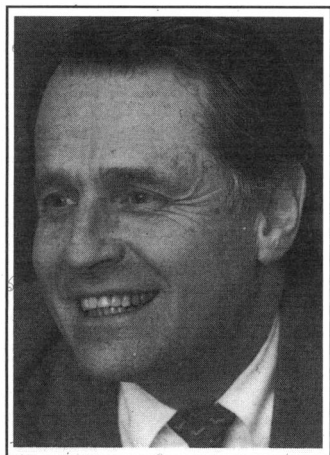


*Ricardo Medem*

Chairman John Deere Iberica S.A.  
CE

Your Majesty. I would like to make just some comments about some of the aspects that, in my opinion, have a great influence on private capital flows. They have been more or less touched by Sir William Ryrie, but I would just like to emphasize some of them. I think that the debt problem of the LDC countries is certainly a deterrent to private capital flows to the LDC countries. I certainly think that perhaps even more effort should be made to find a reasonable solution, not just write them off. Probably more imagination and perhaps more political will ought to be exerted to try to find a solution to this problem. Another aspect that has had an influence – a significant influence in capital flows into LDC countries – is the assessment of the Uruguay round, and the liberalization of services that can be seen as a way of fostering capital flows into LDC countries. Another consideration, or aspect, that definitely has an impact on capital flows into LDC countries, of course, is the financing of the US debts, that, of course, has an influence on the global capital flow situation. I would like to make a comment on what the speaker has said about the growing awareness to attract private capital flows. I think this is absolutely true, and perhaps I would add that to increase this attraction, it is very important that LDC countries consider what kind of policies – and this ties in with what Mr Roderick Hills was saying – what kind of policies, specific policies in the macro-economy, these developing countries could put into effect in order to make their domestic financial markets more attractive to foreign investors. For instance, I think there is a potential for privatisation policies in

developing countries, and I am thinking for instance of Mexico. This way, they could increase the role in their economies of their domestic financial markets and, thereby, increase the flow of financing into their countries to help them in their progress and in their economies. These were just a few comments and consideration to your presentation.



*Jacob Palmstierna*  
Managing Director,  
S-E-Banken  
SNS

Your Majesty. Bankers are supposed to be pessimists, Sir William said here. I do not think that is right at all. We are just cautious, careful, realistic. It is – after all – farmers who are pessimistic. I know, because I am one during the week-ends. Why we have to be careful and realistic is, of course, because we are building our existence on confidence. Lending money, giving credits, is based on confidence that the borrower will be able to pay our money back. If a small borrower has a big loan and runs into difficulties – and then cannot pay – *he* is in trouble. If a big borrower has a big loan we all know who is in trouble – it is the bank. And when we think back a little on what has happened during the last six years, since the world's credit institutions lost confidence in Mexico in August 1982, it is rather an interesting development that has a bearing upon what we are discussing today. Because what has happened since is a dramatic reduction of flows of bank loans into the developing world. That is the main reason why they are in such a difficult situation. Mexico suspended payments because they could not

get new money to pay back interest etc. This started a chain reaction that we have been living with for six years, which we will continue to live with for many years to come. It started, as you know, the muddle-through process, which means that we have had all sorts of negotiations with rescheduling. Rescheduling is a beautiful word for postponing amortizations into the indefinite future. You say that you have a six-year grace period, and then you repay it over twenty years, but God knows what is happening in Brazil six months from now. How can you expect them to pay back things over twenty years? And then, in order to be able to get the cash flow to pay interest, new money. That is another euphemism invented by bankers. New money is money that is lent, so that the borrower can repay the interest, and so that the bank does not have to account for it, in a specific way that is hurting the income statement. This process has had enormous consequences for banks. And banks' book-keeping is an art in itself. However, banks are also exposed to market valuations – I mean the stock market. And if we look upon that, it is a more realistic way of looking at banks. And if we look at the valuation, capitalisation – some rather interesting facts emerge. It is the market capitalisation of the leading banks in each one of the leading countries. For example, the value of the most valuable bank in Japan is about nine times as valuable, according to the market, as is the rest of the banks. Had we a list of the biggest banks in the world, it would have been primarily Japanese all the way down. Another interesting feature, is that in leading countries in Europe: Switzerland, Germany, Britain – banks are bigger than the largest American banks, which is a way of illustrating the fact that the whole financial system in the United States of America is in trouble, due to – not only, but to some extent at least – their generosity during the 70s in lending to South America. Then there are some – a Swedish bank in the middle here – which is about 50 per cent larger than the Chase Manhattan bank, which is another staggering revelation. Now I think we will take that away, otherwise I will have to make further comments.

This process of rescheduling and non-payment of interest etc, has had very great consequences for the banks – but even more so, of course – for the developing countries. Since the Baker plan was launched in Seoul in 1985, only 20 billion dollars, new money has been lent by the banks to developing countries. At the same time they have repaid interest – interest payment of 75 billion dollars, that is a nega-

tive cash flow of 55 billion dollars – to private banks. At the same time, as Sir William said, official aid has been about the same, direct investments have been about the same level – 3 billion dollars a year – so we can clearly see where the short fall comes. And how have these developing countries been able to repay so much on a cash flow basis? I mean, they have not paid all their interest, but they have paid much more than they have received in new money. Well, they have improved their balances of current account significantly. However, these improvements have been brought about primarily by reducing imports and by reducing investments. Consequently the standard of living, the growth rates, have come down appreciably, which, of course, also led to political disturbances – to put it nicely. If you take Mexico as one example: if you compare the figures for Mexico between 1982 and 1987, they have – on an annual basis – increased exports annually by 8 per cent, and reduced imports 17 per cent. They have, in other words, on an annual basis had a zero growth for six years running. At the same time the population has increased by perhaps 30 per cent, which means a reduction in the per capita standard of living by between 30 and 40 per cent. It has been very hard on these countries – to put it mildly. You can also note, that the flight of capital has been reduced, due to more realistic exchange rates and more realistic levels of interest. Nevertheless there is still a flight of capital out of several of these countries.

For us in the banking world, this constitutes a major problem. It is not so easy to go to your board of directors and say: I suggest we give a new loan – as part of this package to Brazil, for instance – when you know that many citizens of Brazil do not have sufficient confidence in their own country to keep their money there. I just take that as one example. Of course, you can mention several others. Anyway, what are the solutions? The simple fact is, that there is no single solution. Grand schemes have been presented by ingenious intellectuals which are – as always – discarded by brutal bankers. Bankers have very great difficulties, and this I think everyone must understand, in accepting the principle that borrowers should not repay their loans. An over-all reduction in loans is not acceptable. Therefore, the guiding principle will be one of individual treatment.

But we also have to consider partial solutions. One is debt equity swaps, and a lot of talk has been heard about this. Debt equity swaps are ways of getting discount. The discount that is prevailing on the

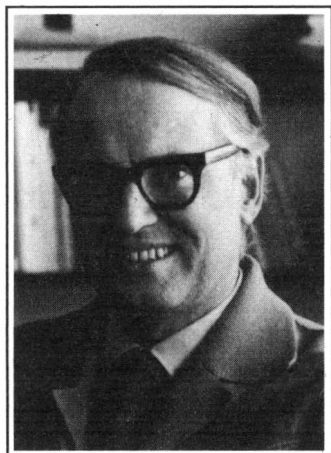
market for assets varies between 10 and 90 per cent. I think, Peru is traded at a 90 per cent discount. Loans to Brazil are traded at a 50 per cent discount, Argentina at 75 etc. You can use discounts to make direct investments and you call that debt equity swaps. However, it is only a small figure. It is a couple of billion a year, at best, so that will not help much. We shall remember that the annual payment of interest for the developing countries is about \$ 40 billion and after rescheduling, the annual amortization is about \$ 20 billion. So when we talk about equity swaps of \$ 2 billion it is a small figure. Direct investments, which are also a small figure of \$ 2 – \$ 4 billion, have, however, a developing effect that should not be underestimated. With direct investments goes know-how, a concern for how the money is used. Therefore, I think that it is imperative that the pressure on the developing countries to create better conditions for direct investments should be sustained.

IMF and the World Bank are also playing with small figures. However, their role is primarily to set policy and standards so that confidence can be increased in order that banks can come back into the game. Then there are suggestions that banks make concessions. Of course this is disagreeable and naturally we have to defend ourselves in this area. However, the fact that there is a secondary market where banks do sell, or can sell loans to these countries, creates a means of giving discounts. Exit bonds etc also makes it possible for banks to save face and to give considerable discounts. Many of us have done that over the years. In my view the tax payer will also have to give discounts, not only through the Paris club, through state concessions of loans, but also by a more realistic treatment of banks when it comes to tax payments, particularly in the United States. In the United States, the banks are taxed on bogus profits. This is, I suppose, a reflection of the fact that the banks in the United States are not among the most popular animals. I have difficulties in understanding why. Of course, at last, the pressure will continue on the problem countries, or high-debt countries, to continue to pursue policies that – in the end – foster confidence. Because that is what is lacking. The difficulty is well illustrated by the recent election in Mexico, when you pursue what bankers call "realistic" policies. It is very difficult to remain in power in democracies. It is perhaps an illustration that the most successful country in South America is Chile when it comes to pursuing market oriented policies.

SESSION IV  
Internationalization  
and Economic Policy  
– Global Perspectives  
*Chairman: Richard Piani, IDEP*



# Policy Autonomy vs Policy Coordination in the World Economy<sup>1</sup>



*Professor Assar Lindbeck*

Director, Institute for International  
Economic Studies  
SNS

## 1 The Problem

The consolidation of national states during the centuries following the medieval period can be regarded as an adjustment of the *political* system to some basic changes in the *economic* system. These changes

<sup>1</sup> This paper integrates and elaborates some points, which I have developed in more detail in the following papers: "The Changing Role of the National State", *Kyklos*, Fasc. I, 1975; "Stabilization Policy in Open Economies with Endogenous Politicians", *American Economic Review*, May 1976; "Economic Dependence and Interdependence in the Industrial World", *From Marshall Plan to Global Interdependence*, Paris 1978. "Industrial policy as an Issue in the Economic Environment", *The World Economy*, December 1981; "Individual Freedom and Welfare State Policy", *European Economic Review*, 32, March 1988; "Consequences of the Advanced Welfare State". *The World Economy*, 11, March 1988; "Svensk Industri i ett Internationellt Perspektiv", *Skandinaviska Enskilda Bankens Kvartalstidskrift*, nr 3, 1988; "Remaining Puzzles and Neglected Issues in Macroeconomics", *Scandinavian Journal of Economics*, No 2, 1989 (forthcoming).

required larger integrated markets of products, factors of production, financial capital and entrepreneurship. The potential efficiency of expanded geographical domains for markets could be fully realized only if the domain of political jurisdiction was also expanded. Therefore *local* systems of currencies, tariffs and infrastructure, as well as local laws and regulations concerning property rights and economic activities, were replaced by *national* systems, laws and regulations. No doubt, the consolidation of the nation state may be also seen as a result of increased returns to scale in the field of military defence, as an expression of cultural and ethnic pride, or as a struggle between individuals and groups for increased political and administrative powers. However, from an economic viewpoint, the nation state may, for the reasons just mentioned, largely be regarded as a political adjustment to new economic forces.

As we know, the geographical domain of markets did not stop expanding at the national borders. It was extended to ever larger geographical areas, generating a more and more "internationalized" economic system. To a considerable extent, the driving forces behind this development come, of course, from technological developments in transportation and communication, which has drastically reduced the costs of sending goods and messages over large distances. However, more recently, another important driving force has been the way in which households adjust their consumption patterns to higher levels of income: people ask for more diversified products rather than just larger quantities of previously consumed products. To satisfy this demand for diversified products effectively, i.e. without sacrificing returns to scale in production, firms in various countries have been forced to specialize in narrow "niches" of differentiated products. This process generates not only a "traditional" expansion of trade *between* different production sectors, but also more trade *within* individual sectors. A country like Sweden, for instance, exports large or medium sized passenger cars and imports small passenger cars. Using an extreme metaphor, countries specialize by exporting blue ladies shoes and importing yellow ones.

However, the contemporary economic internationalization process is not only the result of such technological and taste factors. It has also been simulated by *political decisions*, and related institutional changes. Agreements between governments on the liberalization of trade, the creation of considerable convertibility of national currencies, and freer

capital movements have been crucial prerequisites for much of the recent internationalization of markets for products, capital and entrepreneurship.

When politicians by their own decisions contributed to an internationalization of the economic system, they released, however, forces which were beyond their own powers to control. The national state has, in field after field, become a less efficient unit of policy-making than before, as a result of increased international economic dependence and interdependence. Many problems of the world economy of today can fruitfully be seen in the light of the tension that has emerged between a strongly internationalized economic system and a political system of sovereign national states. This tension has been accentuated by the fact that *domestic* political objectives have been both more ambitious and more detailed during recent decades. This is reflected in the enormous expansion, in particular after the second world war, in the scale of government intervention in domestic economies, including the expansion of government spending.

A main *advantage* of the internationalization process is, of course, that the efficiency in the allocation of resources is boosted by way of a more efficient division of labour, a more rapid spread of technology and information, as well as by increased competition, which tend to cut out slack in the production system. A conventional view is, however, that these advantages occur at the expense both of *increased instability* of the national economies and of *less autonomy* for national economic policies.

Let us take a look at these asserted "disadvantages", and at the possibilities of dealing with them. It is then useful to start with the issue of stabilization policy, i.e. the ambitions of governments to influence aggregate capacity utilization, employment, inflation and the balance of payments. Later, I will turn to "allocation policy" and "distribution policy".

## 2 Stabilization Policy

### *Macroeconomic Disturbances*

A first, conventional view in the public discussion on stabilization policy seems to be that an "internationalization" of a national economy

will increase the vulnerability of that economy to foreign economic disturbances. The reason would be that economic fluctuations are transmitted across national borders with greater force in highly open economies than in more closed ones. However, this reasoning uncovers only *one* side of the coin. The other side is that disturbances that occur *within* a certain national economy tend to hit that economy itself less violently in the context of a highly internationalized economic system; the consequences of the disturbance will be "internationally dispersed". For instance, in an internationally integrated economic system, a sudden increase in domestic demand for goods and services, or a sudden decline in domestic productivity (for instance due to a bad harvest), partly "leaks out" through the current account of the balance of payments. This leakage mitigates the domestic consequences on output, employment and prices. Similarly, shifts in domestic demand and supply for credit tend to generate changes in international capital flows rather than in domestic interest rates, and hence real investment and production, etc.

In other words, economic integration functions like an "insurance system", by defusing the consequences of economic disturbances in individual countries, spreading the effects throughout the world. For countries with considerable domestic disturbances, economic stability will then be enhanced by an "internationalization" of the economic system, as the effects of domestic instability are spread outside the borders of the national economy. If individual disturbances are not synchronized between countries, economic stability in the *world economy as a whole* will also be enhanced by economic internationalization.

### *National Autonomy*

Another conventional view is that the national autonomy of stabilization policy falls as a result of increasing internationalization of economies. Domestic policy instruments are asserted to become less effective in highly open economies. But – like so many other conventional wisdoms – this view is at best a half truth.

Generally speaking, we may say that international integration of markets tends to make *demand management* policies *less* effective. The basic reason is, of course, that the more open an economy is, the larger share of the effects of increased domestic demand tends to "leak

abroad". This argument holds not only for general *fiscal policy* actions like sales taxes, income taxes, transfer payments and government demand for products. It holds for *monetary policy* as well. With internationally integrated financial markets, even small changes in open market operations, for instance, tend to generate large international capital flows, without much effect on domestic real investment and consumption.

In other words, traditional "Keynesian" demand management policy tends to be less effective in influencing domestic economic activity when the economy becomes more internationalized. But on the other hand, policies designed to influence *aggregate relative prices* tend to have *stronger* effects on the domestic economy. This is because changes in aggregate relative prices have a stronger impact on domestic production when domestic and foreign demand and supply of goods and services are close substitutes, which tend to be the case when national economies become highly internationally integrated. This means that "relative price policies" such as changes in exchange rates and tariffs, as well as taxes and subsidies on wage costs, tend to have stronger effects in highly open economies than in more closed economies, by strongly influencing the profitability of domestic output as compared to production in other countries. This also means, of course, that *policy mistakes* in the field of "relative price policies" will have more damaging effects on the domestic economy in an internationally highly integrated economy than in a more closed one. Obvious examples are "overvalued" exchange rates and domestic "wage cost explosions", which may create domestic stagnation, low investment activity and high unemployment.

### *Contemporary Examples*

It is easy to find contemporary examples of the international repercussion of macroeconomic disturbances and related problems of macroeconomic instability. The most obvious contemporary examples are perhaps the "global effects" of (a) public sector budget deficits, in particular in the US, (b) the trade imbalances between leading industrial countries, and (c) the related increase in foreign debt. Why would then these features constitute serious problems?

The "basic" economic consequence of a large *government budget deficit* in a country is probably that the saving propensity of that coun-

try then tends to fall. Experience indicates that private saving seldom fully compensates for reduced public sector saving. Moreover, if public sector saving falls in a large country, or in several medium sized countries simultaneously, the saving ratio of the world economy as a whole tends to fall with rising real interest rates in the world economy as a result.

As an illustration, in combination with the falling saving of the OPEC countries in the eighties, and restrictive monetary policy in both the US and Europe, the budget deficits in several countries, including the US, is an important explanation of the rise in the real interest rates in the world economy in the eighties – with negative consequences for global capital formation. This is perhaps not a major catastrophe, but it has kept down long-term capacity growth of the western economies by a few tenth of a percentage points per year. The high interest rates have also held down capacity utilization and employment growth in the world economy. It should be remembered, however, that the fiscal policy actions that generated both the budget deficits and the high interest rates, by itself, has been a strong *expansionary* force on aggregate demand in the world economy. This means that we cannot really blame the world recession in the early eighties on the fiscal policy that has generated high interest rates.

How serious are then *the disequilibria in the current accounts*, and in this connection the growing *foreign debt* of various countries? Current account deficits at the level of a few percent of GNP each year have during the course of the centuries been a rather "normal" feature in the historical development of the world economy. Foreign borrowing is simply a method to even out the consumption profile over time for the inhabitants of a country – sometimes, but certainly not always, in connection to increased real investment. As historical examples, we may mention that Canada, Australia and Sweden had rather permanent annual deficits in their current accounts of about three percent of GDP per year from the middle of the 1870s to about the first world war, without people expressing much worry – partly because the borrowing was used to increase domestic investment but partly perhaps also because balance of payments statistics were hardly published at that time!

Why is then serious concern so often expressed today about current account imbalances and related increases in foreign debt? In the case of some *developing countries*, the worries are easy to understand. First,

the borrowed funds have *not* often been used in a "prudent" way. In some developing countries, they have been used to boost domestic consumption, and in others to increase poorly allocated and poorly implemented investment – often in large public sector projects that will never yield much of a return to the national economy. The situation is particularly severe in countries that have combined heavy foreign borrowing with discrimination against their own foreign trade sector, in spite of the fact that it is only by an expansion of the tradeable sector, relative to domestic demand for tradables, that the debt could be "serviced" in the future.

Indeed, we know already now that many of these countries will not be able to service their debt during the coming years. The problem has, of course, been accentuated by the rise in nominal interest rates during the eighties and the fall in the terms of trade for many developing countries. The combined effect of these events is that the relevant real interest rates have also increased. For instance, suppose that the debt of a country is 100 percent of GDP, and that nominal interest rates rise to 15 percent, at the same time as export prices fall by 10 percent per year during a number of years (at constant import prices). As a result, the relevant real interest then become 25 percent (15 plus 10). This means a "resource cost" for the foreign debt of no less than 25 percent of GDP – a rather hopeless situation in many countries. Moreover, even when the fall in terms-of-trade stops, the country is left with a much larger *real value* of its debt than before I measured in terms of domestic resources.

Some of the debt of developing countries has, as we know, already been rescheduled, other parts are in fact never expected to be repaid. Of course, this creates a problem of liquidity and solvency for a few individual western banks. However, the "bad" debt to developing countries is really too small to be a major threat to the banking systems of the West, though some additional rescue operations by governments may be necessary for individual banks.

But why is so much concern also expressed today about the current account deficits and the debt position of *developed countries*, like the US? After all, the US debt is less than ten percent of GDP. With a "normal" long-run real interest rate of 2 percent, the "resource cost" to the US economy would be no more than 0.2 percent of GDP – a trivial burden on US citizens. In other words, the resource cost for US citizens cannot possibly be a major problem. What, then, is the problem? Some participants in the US discussion are obviously psychologically

”offended” by increased foreign ownership of US property, when part of the US debt is converted to foreign ownership of real assets in the US, such as shares and real estate. However, forgetting this problem of ”national pride”, there is at least one important problem.

For when a country, with the size of the US, has a large current account deficit for several years, problems of *international financial instability* may emerge. More specifically, when the US in the mid-eighties was unwilling to accept the rise in interest rates that was required to induce asset holders in the world to absorb the increased supply of US debt instruments, the US authorities had to accept some monetization of the US debt, and this increased an excess supply of dollars. As a consequence, national banks in other countries were forced to choose between accepting rising exchange rates against the dollar, on the one hand, and domestic monetary expansion in connection to the purchase of dollars, on the other. This created continuous uncertainties among private agents about the choice of policy strategy by various governments (and central banks), due to the re-occurring shifts in these strategies by governments. This is, most likely, one important reason why new information among private agents about macroeconomic aggregates, such as public sector deficits, current account deficits, inflation and unemployment recently have had such drastic consequences for the *expectations* among agents in financial markets – and from there on exchange rates and other asset prices, as we have recently witnessed. However, many ”informed observers” probably also agree that recent volatility in financial markets reflects ”financial bubbles”, i.e. the consequences of self-supporting expectations, which are not based on ”fundamentals” including government policy and expectations about such policy.

How serious is then such financial instability – whether it depends on unstable policies or is related to self-supporting bubbles? Of course, we know that drastic *permanent* reductions in wealth have considerable effects on spending, and that prolonged periods of high real interest rates have considerable effects on private investment, including the purchases of durable consumers’ goods. We also know that prolonged periods of deviations of real exchange rates from ”fundamentals”, i.e. exchange rates that drastically deviate from the relative cost situation for the tradeable sectors in different nations, may have strong effects on output, employment and capacity growth. However, it is less clear that *short-term instability* in these various asset prices have strong effects on

the non-financial, i.e. the "real" part of national economies.

First of all, agents have considerable opportunities to guard themselves against fluctuations in prices of financial markets by diversifying their financial portfolios, and by operating on futures' markets, including the futures' market for foreign exchange. Moreover, we should not expect that changes in wealth that simply reflect *bubbles*, or the bursting of bubbles, have strong effects on household spending. Similarly, short-term fluctuations in real capital costs may not have much effect on real consumption and real investment, as households and firms may adjust *the timing* of the financing of their spending, rather than the level and timing of spending itself. Short-term fluctuations in real exchange rates do not necessarily result in shifts of real resources back and forth between sectors within a country, or between different countries, as the costs of such shifts are huge.

However, in principle, increased instability of real exchange rates would be expected, on the average over a number of years, to favour production in the non-tradeable sector at the expense of the tradeable sector, by increasing the uncertainty of production and trade in the latter. Real exchange rate instability would also be expected to induce firms not only to diversify their portfolios between financial instruments in different currency denomination, but also their real capital assets, i.e. their production plants between countries to limit the variability over time of profits, output and employment. Here, then, is another driving force for the previously discussed internationalization of production firms.

### 3 Allocation and Distribution Policy

The internationalization of the economic system has profound consequences not only for macroeconomic (stabilization) policies, which I have now discussed, but also for policies concerned with the *allocation of resources* in individual countries. First of all, competition among individual firms tends to increase. As a result, profit margins will be squeezed in. Moreover, as new nations join the industrialization process, earlier successful industries in various developed countries find that they have lost the competitive edge in certain traditional industries. In other words, the comparative advantages between industries tend to change. This would be expected to result in a tendency to a more rapid

rate of structural change, and hence also increased tendencies to frictional and structural unemployment.

It is unavoidable that such developments induce governments to react — particularly in view of the earlier mentioned increased responsibilities that national governments have shouldered in many countries during the post World War II period. This is also an important background to various attempts by governments to develop new, and more selective (discriminatory) *policy tools*. The perennial recommendations of "new industrial policies", and related tendencies to neo-protectionism and neo-mercantilism, should be seen in this context. Obvious examples are the implementation of policy instruments such as discriminatory fees on imports and so-called "voluntary restraints" of exports of other countries, as well as subsidies on export, domestic production, employment and research and development; public capital grants and subsidized credit; the tying of foreign aid; protectionism in government procurements; the exploitation of regulations of product standards for protectionist purposes, etc.

However, it is probably fair to say that the long-term result of such "industrial policy" interventions have usually been disappointing in most countries where they have been tried. This is the case not only in countries with incompetent, or even corrupt regimes, but also in countries with generally competent and reasonably honest governments, in particular in countries with highly competitive political systems and strongly organized interest groups. In general, politicians and public administrators usually lack the information, the special industrial competence, and often also the long-term outlook that is needed to pursue a successful selective industrial policy. "Industrial policies" therefore easily end up as tools of influence in the hands of special interest groups. Thus, even though economic internationalization tend to increase the political pressure for more interventionist government policies in the field of resource allocation, and even though tools for such policies are easy to develop, there is certainly a strong case against pursuing such policies. I think it is also fair to say that many countries that have tried selective industrial policy today rather want to abstain from such policies in the future and instead want to pursue policies that improve the general economic, social and political environment for entrepreneurship, production and investment. There are some counter-examples, of course, in particular among opposition parties in countries that have not tried "industrial policies".

The process of economic internationalization may, of course, also have considerable consequences for *distribution policies*, including various types of welfare state programs. However, even in a strongly internationalized economic system the degree of national autonomy is quite high for income redistributions by way of tax/transfer programs, as well as for the supply of public services ("public consumption"), such as education, health, old age care and child care. I would, indeed, take the position that the "limits" to such policies are mainly set by *domestic* factors rather than by international complications. In particular, I am thinking of the distortions to economic incentives in connection to (i) high marginal tax rates and (ii) various asymmetrical features of the taxation of assets of different types, as well as (iii) limitations to individual freedom of choice, and (iv) problems of tax evasion and the related need to build up controls of firms and the economic lives of individuals.

However, there are certainly also some international complications, in particular if one nation differs *strongly* from the rest of the world for long periods of time. For instance, in a world without exchange control, large differences in the taxation of capital would be expected to generate strong capital flight and considerable tax evasion. By contrast, labour income taxes and sales taxes can, no doubt, be kept a lot higher in one country than in others, without large groups of households deciding to emigrate or to engage in "border trade". But there are definite limits to the magnitude of such differences as well. In particular, drastic income tax differences may in the long run induce some citizens with high education and special talents to move abroad. Generous social benefits may, on the other hand, attract foreigners with low skills to the country. Indeed, the latter possibility is a reason why welfare states maintain strict controls over immigration, in particular if per capita income is also relatively high in the country.

High income taxes and payroll taxes may also induce firms to shift "qualified activities" abroad, such as R and D activities, and perhaps even their headquarters. Otherwise the competition for talents would force the firms to pay extremely high gross salaries for specialists. We also know that the combination of high income tax rates with high wealth and inheritance taxes may induce family-owned firms to move abroad. Indeed, there are some examples of this in Sweden; I think, of course, about firms like Tetra Pak and IKEA, but there are lots of less spectacular examples.

## 4 International Economic Coordination

What are then the consequences of all this for the need for *international coordination* of national policies? Some people argue today that the internationalization process has come to the point where a full and complete harmonization of economic policies between the developed nations is necessary to ensure economic stability and prosperity. What can be said about this?

Let us start with stabilization policy. It is then important to note that most national economies are not yet so closely integrated that national stabilization policies have become powerless. For instance, even though general demand management by way of fiscal policy is not as effective as before as a tool of influencing domestic output it is far from powerless. For instance, the level of aggregate employment can, for a considerable time period, certainly be boosted by higher *public sector employment* – though at the expense of efficiency in the domestic allocation of labour. The "autonomy" of an independent domestic inflation trend is, of course, also huge, provided the exchange rate is allowed to adjust. I have also pointed out that some policy tools that change aggregate relative prices, such as relative production costs, real wage rates and real exchange rates, are indeed *more* powerful in highly integrated economies than in more closed economies. However, this greater influence occurs because the actions disturb other countries, by inducing *substitutions* of demand and production between countries. The risk of retaliation from other governments will then in many cases be expected in connection to such policies.

Of course, small countries, in particular if they do not belong to common markets, may allow themselves greater freedoms in this respect without much fear of retaliation. Thus, not only is it possible for small and politically independent countries to take "free rides" on business upswings, or on reduced inflation abroad. They may also, by way of devaluations, improve domestic production and employment, though at the expense of higher inflation – without severe risks of retaliation. The aggressive devaluation of Sweden in 1982 is an obvious example.

There is also a considerable national autonomy for policy actions *on the supply side of the economy*. This is important as the efficacy of demand management policies in an individual country can be considerably improved upon if the supply side is made more flexible. There are

some obvious reforms that can be implemented here: lower marginal tax rates and the removal of rent control, as well as actions against restrictive practices of labour unions, in order to improve the mobility of labour; fights against monopolies and cartels in the markets for products and capital, removals of various obstacles to the entry of new firms; reductions in the hiring and firing costs of labour; improvements in the public infrastructure, etc. The Swedish experience also indicates that the functioning of the labour market may be improved by the *coordination* of the systems of labour benefit system with job exchange systems and labour retraining programs. For then unemployment workers may be stimulated, by the carrot as well as the stick, to accept either job offers or retraining, by being threatened by the withdrawals of unemployment benefits if such offers are turned down.

What then is the potential contribution of international coordination of stabilization policies? One situation when such coordination is potentially helpful is, of course, when there is either a deep recession or a strong boom for the world economy as a whole. In this case, independent policy actions by individual countries cannot be very effective, because a large part of the effects of domestic policy actions "leak" abroad. To avoid free-riding behaviour of individual countries in this case, some formal agreements about "concerted actions" are certainly *potentially* useful. However, experience during several decades shows how difficult it is to agree about, and to implement, such coordinated actions. After all, the government in each country is only responsible to its own electorate. Indeed, there is even a risk that demands for policy coordination become an excuse for not pursuing responsible domestic policies; talk about the need for international policy coordination may give a national government a chance to blame other governments for problems that have been created by its own actions.

A second situation when there is a strong case for concerted international action is when it is important to correct imbalances in the current accounts in the balance of payments, without creating strong negative effects on aggregate economic activity for the world as a whole. The present situation is an obvious example. Reduced absorption of resources in the US, which is necessary to reduce the US current account deficit, would certainly have depressive effects on the outside world. The point has, of course, received considerable attention in recent years. Still we note how difficult it has been in the US to reduce domestic absorption, and how reluctant the surplus countries –

primarily West Germany and Japan, South Korea and Taiwan – have been to increase domestic absorption in order to compensate for a hypothetical reduction in US demand for goods and services. The conclusion is that it is difficult for governments to take action *before* these are necessary for domestic policy reasons. It may therefore be necessary for a deficit country, such as the US today, to *start* reducing its absorption hoping that other countries will, in fact, expand domestic demand as soon as they feel the depressive effects of reduced demand abroad.

A third situation when there is a case for policy coordination is, of course, the "classical" one when countries want to avoid "beggar-thy-neighbour policies", for instance by way of aggressive devaluations, trade restrictions or mercantilistic subsidies. Customs unions, common markets and currency unions are obvious institutional arrangements to achieve this – in addition to the surveillance rules of international organizations like GATT and the IMF. Then we are really on the borderline between stabilization and allocation policy. Indeed a strong case for coordination in the field of economic policy is just to prevent countries from disturbing the international allocation of resources for the purpose of increasing domestic capacity utilization and fighting unemployment. Indeed, the most important need for "international coordination" of allocation policy is probably the "negative" task of preventing discriminatory measures in individual countries, either for stabilization policy purposes or to support special interest groups.

The case for more "positive" international coordination in the field of allocation policies is perhaps strongest in the field of transport, communication, infrastructure and government procurements. Here the fragmented national rules and structures in Europe probably has much to gain on "policy coordination". It is, perhaps in this field where the development of a unified "internal market" within the EG could be particularly important.

A fourth situation when it is often argued that there is a case for international policy coordination is when exchange rates are completely out of line. However, it is really an open question how useful international coordination is in this field. One reason for some scepticism is that it is very difficult for any government to know what "reasonable" exchange rate is; it is even more difficult for several governments to agree about it. Experience also shows that it is doubtful if governments today really are *able* to control nominal, and real, exchange rates for long periods of time. Perhaps it is wise to limit

coordinated exchange rates interventions to situations when the exchange rates are so dramatically out of line that nearly "everybody" agrees that this is the case, such as the exchange rate situation between the US and other major countries in 1984–85.

Of course, some small countries may want to create confidence in a non-accomodating exchange rate policy stance by joining a "currency union", even though that country would then be forced to subordinate not only its monetary policy to the dominating member of the monetary union, but also the rate of domestic wage change.

Finally, if also the labour market became highly internationalized, with greatly increased international mobility of labour, countries may be forced to streamline their welfare state systems. Otherwise, some of them will run into the "New York problem" of the fifties and sixties, when poorly educated labour from all over US clustered to New York partly to reap the relatively high welfare benefits there. Greatly increased labour mobility would also create some increased need for levelling of marginal tax rates.

Moreover, politicians in individual countries who understand the severe damage that extremely high marginal tax rate inflict upon a society – and such politicians do exist – will most likely use "the need for international coordination of taxes" as an *argument* for lower marginal tax rates, even though the main motive really is to reduce the damage on domestic incentives. Of course, one cannot always be confident that *arguments* and *motives* coincide in political life.

## 5 Final Words

However, let me conclude with a very general comment: an internationalization of the economic system certainly tends to reduce the autonomy of national policies – regardless whether the policy is internationally coordinated or not. This loss of autonomy is usually regarded as a disadvantage, a "price" we have to pay for the efficiency gains from foreign trade and for the access to worldwide markets for goods, services, capital, technology, information, entrepreneurship, etc. However, it is possible to look at reduced national policy autonomy in a different way: Citizens may in certain cases actually *enjoy* a reduction of the autonomy of national economic policy. If the government is prevented from disrupting the domestic economy, for instance by short-term "election politics", or from destroying economic incentives,

reduced autonomy of domestic economic policy may, in fact, be regarded as a blessing. Indeed, even many government officials may themselves be happy to take on a "straight-jacket" in order to limit some of their freedom of action.

The government may find that it becomes less vulnerable to domestic pressure groups by accepting external restraints on its freedom to act. For instance, it may be more able to resist such domestic pressures by being able to refer to international agreements – about for instance fixed exchange rates or trade policy rules à la GATT. To resist such pressures may sometimes be easier than having to argue against the pressures in each individual case. Thus, the issue of national autonomy versus international policy coordination is a rather complex one. There may not only be disadvantages, but also advantages of reduced autonomy for national economic policies.

# Comments



*The Lord Roll of Ipsden*  
PSI

As you would expect from so eminent an economist as Professor Lindbeck, he has in one bound taken us way above the detailed and minute preoccupations of the last day and a half, and very appropriately brought us into contact with much more rigorous, if however, abstract analysis of the issues with which we have been concerned. Unfortunately, there is very little time to deal with the great list of problems which he has put before us today. Moreover, while many years ago, when I could still think of myself as something of an economist, I would have had much more confidence in commenting on them, now, after the corrupting influence of many years in governmental affairs, and perhaps a slightly less corruptive influence of many years of banking, I do not feel quite so confident in following on these very steep alpine paths which he has trodden in his analysis.

Furthermore, I think after what we have heard this morning from Mr Kouri about economics and economists, I am not so sure that I should really regret what I have just said, because, as you will remember, Mr Kouri stated that economics does not help you to make money, and he also said at one point, when he was dealing with the explosive developments of financial markets, that economics is quite incapable of understanding the economy. Hence I sometimes wonder what it is all about. I might remind you for a second of the old chestnut regarding the definition of an economist as someone who, if you have forgotten your

telephone number, will estimate it for you. However, let us not descend into these obscurantist views about economics. I can assure you, I for one still have considerable respect for economists.

I think that what Professor Lindbeck has given us will require very, very careful reading, and very, very careful studying when you have the text of his remarks before you. It is, I think, of extreme importance in understanding all the more detailed issues that we have had earlier today and yesterday. Since there is so very little time, may I just concentrate on the central approach of his paper, which he has just given us, namely dichotomy, or apparent dichotomy, as I shall argue in a moment, between autonomy of national policy making, and internationalisation or coordination of economic policy. He has said, and I wholeheartedly agree with him, (and this is a point already made by Isaiah Frank yesterday), that the development of the economic system, first of all because of its own immanent technological developments, and secondly of certain political developments in the field of liberalisation, of trade, services, capital movements etc., which may themselves be, to some extent, independent of the will of the policy makers, over a period of time is, whatever we may say, becoming increasingly international. Hence, you are faced with an increasingly international economic system, the pace of which will, of course, vary from time to time, as Professor Lindbeck has pointed out.

This development of the economic system does come up against political boundaries as it did in the old days, when the nation state emerged really as means of widening the political boundaries, within which the economic system could develop. Now if this process is going on anyway, whatever we may do, and at whatever pace it may take place, the dichotomy between autonomy of policy making and the internationalisation of the economic system, and therefore the question of to what extent coordination can be of help, takes on a somewhat different hue.

Let us look at autonomy for a moment. I think Professor Lindbeck has given us a very good guide as to how this is to be defined, because he has divided national economic policy making into stabilisation policy, which deals with employment, growth rates etc., allocation policy, which deals with the efficiency of the price system within the economy, and distribution policy – which deals, of course, with the demands made upon the national economy, for reasons external to the economic system, namely social purposes, welfare systems etc. Now, if in these

regards, the autonomy of national governments is in any event going to be considerably restricted, I would suggest to you that the real question to ask is to what extent international coordination of policy, i.e. some system which enables national governments to participate in the international resolution of international economic problems, can actually produce a greater degree of power of the resolution of economic problems, than certain "local difficulties", as Mr Macmillan once called it, inside our Cabinet. I will not enlarge on those aspects here today, but it is to my mind an example of how institutionalised coordination of economic policies is not necessarily the sum total of coordination of economic policy. Very often things are done nationally because of international imperatives, without actually carrying the label "international coordination" about them. Therefore, I would like to put to you, that it may well be that the question should be posed in quite a different way. Perhaps the question should be this, and need I say just parenthetically, that the way you pose a question also to some extent implies the answer you are going to get. I mean, if you say: "Have you stopped beating your wife", I think that question already implies a certain attitude which perhaps is not intended. Similarly, I think by posing the question in terms in which it has been posed here, we may to some extent have created a prejudice in regard to the answer. Perhaps the question should really be something like this: Since national decision-making, or the autonomy of national decision-making, in many areas of economic policy, is more or less rapidly being eroded by the process of internationalisation of the economic system itself, and may indeed be on the way of disappearing, at least in many important areas of decision-making, then would not really be the question, how much international coordination would make the internationalisation of the economic system on balance more effective, and more beneficial to the participating national economies. Secondly, if that question can be answered, what purposes should this international coordination serve, how should it be pursued, and above all, by what means. This, of course, is a very big area, which obviously at this moment I cannot start on, as I see the Finance Minister has arrived, and I do not want to deprive him of any more time. But may I say, that if we are really reformulating the question in this way, I would like to suggest to Mr Morgan, who, I believe, is going to have a part to play in organising the next similar meeting in Australia next May, that this might well be put on the agenda for the next year.

# Internationalization and National Economic Policy



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It is a great honour for me to speak in front of such a distinguished audience as that gathered here today. I have been allocated the task to speak about policy-making in an increasingly internationalized world. I will use this occasion to share with you some thoughts on the need for international coordination of economic policies and, in particular, the need in many countries to fight unemployment with much more determination.

During the past fifteen years, we have witnessed a variety of macroeconomic problems in the international economy. We have seen sharp changes and fluctuations in exchange rates, low growth in world trade and, during the 1980s, historically large external imbalances for the major industrial countries. On top of this we have a very serious unemployment problem developing, particularly in Europe. There are, as we all know, various factors, including exogenous shocks which can explain this less favourable performance. I will concentrate here on one set of reasons, or, as I see it, the serious shortcomings in the way economic policies have been designed and managed. In my view, there has been a lack of international economic cooperation to cope with

macroeconomic problems. In particular, much too little attention has been given to the problem of unemployment.

Views on international economic cooperation have changed over time. During much of the 1970s and the 1980s, the predominant view was non-cooperation, often expressed with the slogan "keep your own house in order". The first years of the 1980s were particularly dark in this respect. Words such as policy coordination, or even consistency of policies at the global level, were banned from discussions in international fora. This happened when countries were carrying out clearly incompatible fiscal and monetary policies which contributed to large financial imbalances. Or to put it shortly: when cooperation and coordination of policies were more needed than ever.

The climate in this respect changed quite markedly with the change at the top of the U.S. Treasury in the second Reagan administration. The Plaza meeting in September, 1985 is often mentioned as a watershed in this development. From then on, in international policy discussions in the IMF, in the OECD and elsewhere, the issue of how to coordinate policies in major countries could again be addressed.

However, this change in attitudes has not yet produced a corresponding adjustment in actual policy making. Practical cooperation also after the Plaza meeting has largely been confined to administering exchange rates through interventions in currency markets. Indeed, this is not a satisfactory state of affairs. In my view policies have not yet been framed to what is often called "fundamentals", i.e. to properly address both the present large payments imbalances between the major countries and the unemployment problem.

When searching for better international economic cooperation, the immediate question to ask is, of course, if the present framework could be improved. For me this undoubtedly puts the international monetary system itself in focus. In my view a reform of this system has become necessary. The goal should be to create rules and, even better, mechanisms which would more or less impose cooperation at the international level and coordination of policies on the major actors.

Various proposals have been made with a view to producing greater discipline and strengthened coordination within the international monetary system. Target or reference zones for exchange rates is one option that has been discussed and that deserves continued attention. One advantage with the target zone proposal is that it offers the possibility to proceed in stages. A first step could be to strengthen multilat-

eral surveillance by using target zones, announced or unannounced, as a trigger mechanism for multilateral consultations about economic policies.

If set up and applied for some time, a system of this type would produce valuable experience for assessing its usefulness. It could then prove possible to lay down further rules and to codify the next step to be taken. One attraction with this system is that it addresses "fundamentals" at the same time as central importance is given to more stable conditions for exchange rate — an objective shared universally.

It is highly welcome that multilateral surveillance as it is exercised in the IMF and in smaller groups is being strengthened. In the monetary fund economic indicators are being developed to help provide a basis for a common analysis and appraisal of the policy setting. In my view the system with indicators should be developed further, the purpose being not only to detect potential tensions in the international economy but also to help doing something about them. Fully developed, the system would mean that the indicators should be used as a trigger for consultations with a view to agreeing on appropriate policy action. In fact, such a trigger mechanism could constitute a first step in a process of introducing greater elements of constraint in the exchange rate system itself. Like many other things, international cooperation in the economic sphere has its ups and downs. As I mentioned earlier it has not been much to brag about over the past several years. Looking to the future, however, I can see factors indicating a more promising outlook. The most important, perhaps, is the simple fact that experience from the "keep your own house in order" — era was generally so negative for all involved. Therefore, I am convinced that it will take quite some time before a new "non-cooperation" — experiment is tried again. But I also detect a more genuine interest in cooperation, even if this so far has been in rather modest measure. I am thinking of the cooperation over the past three years to realign the exchange rates for the major currencies as well as the more recent experience managing from the financial crisis after the stock crash last year. I also believe that the debt problem, seen in isolation, has produced a heightened awareness among the major actors of the international repercussions of national economic policies.

I will now change perspective to that of a small economy. For a small open economy, international economic cooperation is, of course, extremely important given its relatively less weight in affecting the

external conditions. This doesn't mean, however, that a small country cannot to a considerable extent steer its own course. In the case of Sweden, we have paved our own way in one important respect. At a time when unemployment in Europe has hit approximately 20 million persons, or almost 11 percent of the labour force, the rate of unemployment in Sweden is well below two percent. Professor Richard Layard has referred to the Swedish performance as "an astonishing achievement".

In a decade when there has been social experimentation in many countries, e.g. in terms of practical monetarism", or what you may like to call it, the Swedish approach has remained a bit old-fashioned – many would say – but has worked quite well. Behind our good performance, lies a combination of prudent fiscal and monetary policies and traditional Swedish labour market policies. I think the appropriateness of these labour market policies is becoming increasingly recognized outside Sweden. I would like to linger on our approach to the employment issue and on our labour market policies.

When the Social Democratic Party came to power in the thirties their program began with these words: "The whole population at work is the primary goal of our economic policy." That ambitious objective is today as valid as ever. Our commitment to full employment is based on the following ideas

- unemployment causes human suffering,
- unemployment represents economic waste,
- unemployment is the biggest source of inequality,
- unemployment is undermining people's, and particularly young people's belief in the capability of the democratic system to create work for its citizens and this weakens confidence in democracy.

The basic idea behind the deflationary policies carried out in many countries at the beginning of the 1980s was that a period with high unemployment would bring down inflation. After a few years of higher unemployment, it was argued, that more favourable economic growth would ensue and start creating new jobs again so that the unemployment figures would be reduced.

Now, this has turned out to be completely false. In many countries, the non-accelerating inflation rate of unemployment (NAIRU) has been driven upwards. At present, a considerably higher rate of unemployment is needed in order to keep inflation stable despite the fact that the

unemployment benefits have become less generous in several European countries. The earlier presumed relation between unemployment and inflation does not seem to stand up to facts. This has to do with the changed characteristics of unemployment.

What has happened is that unemployment has tended to increase for individuals outside the traditional hard core of the labour force. In many countries, young people, women and elderly men have found it increasingly more difficult to get a foothold in working life. They are forced to long periods of unemployment, they become discouraged and compete less vigorously for jobs. One consequence is that they exert less downward pressure on wage cost inflation for any given level of unemployment, and hence the higher NAIRU.

The unemployment that has been generated in Western Europe does not have the restraining effect on wages and inflation previously thought in economic theory. The high level of unemployment is nothing short of a huge waste of human resources. These new insights imply that the view that the level of employment can be used as an instrument in economic policy-making must definitely be abandoned. If every increase of unemployment adds to the number of jobless people, creating a *permanent* high level of unemployment, it becomes imperative for governments in *all* situations to prevent unemployment from increasing.

When in the early 1980s, the rate of unemployment increased considerably in Sweden, we saw that this led to an increase in the length of the spells of unemployment for various groups. Such an increase in unemployment hadn't and couldn't be expected to have any dampening effect on wage and price increases.

An important conclusion to be drawn from the Swedish experience is that fiscal and monetary policies must be supported by active labour market policies. For almost forty years, since Göran Rehn and Rudolf Meidner presented their ideas, labour market policy has been a salient feature and integrated part of our general economic policy. I also want to stress that we have throughout primarily relied on active labour market policies. This means that we put job creation, mobility incentives, training and other measures of vocational preparation first, while pay handout are only to be considered when all other measures are exhausted. In this respect we differ from most other countries which devote most of their financial resources for labour market policies to pay handouts. In the fiscal year 1986/87, we used about 70 per cent of

labour market expenditures on *active* measures while the corresponding figure in for example Great Britain was about 30 per cent and in France 20 per cent.

It is often alleged that Swedish labour market policies are expensive in an international context. This is simply not correct. Expenditure on labour market measures totaled some 3 per cent of GDP in 1986. We were at the same level as Great Britain, below France and Spain and substantially below Belgium where expenditures for labour market policies reached some 4,5 per cent of GDP.

What does our active labour market policy then consist of? It has three basic elements:

1. A job exchange with a placement service which contributes to a rapid and effective adjustment of the supply and demand for labour. Serving both employees and jobseekers the main objective of the job exchange is to get job openings filled as soon as possible and to help job seekers find a job.

A second element is the human resource development programs.

Those who cannot find a job through the placement service need more advanced forms of employment service. This often goes for young people who need counselling, women entering or reentering the labour market, displaced workers who need training or retraining to find new employment, disabled workers who need both counselling, rehabilitation and training.

3. A third element is the job expansion programs. For some job seekers, neither the placement service, nor the human resource programs are sufficient or adequate. Demand side measures, or job expansion programs are necessary.

These demand side measures are based on economic incentives to stimulate the demand for labour where and when it is necessary. Incentives are used to make employers hire those who are unemployed.

That goes for teenagers, who are guaranteed at least a 4 hours a day job, for disabled workers, and for other job seekers with a particularly weak position in the labour market.

These programs in various combinations are used all over the country in day-to-day operations to improve the functioning of the labour market. The aim is to meet the aspirations of individuals for jobs and security, and to meet the need of production for flexibility. These programs have played a central role in the restructuring of Swedish indus-

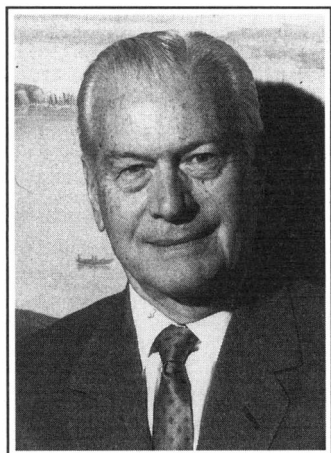
try. The active involvement of the authorities has increased the acceptance by labour unions of a need for structural change. An active labour market policy thus strongly contributes to economic growth. Thus, it is wrong to see labour market policy as a social program to finance the unemployed. Instead, it should be an integrated part of demand management and supply side policies.

I spoke initially about the need for international cooperation in the field of macroeconomic management. There is also a strong case for international cooperation in microeconomic or so called "structural" reforms. During the last few years the need for structural reforms in various areas has become increasingly emphasized in different international fora. The completion of the internal market in the EEC can be taken as an example of the heavier stress laid upon structural issues. In the OECD, intensive discussions on the need for structural change have been going on during the last few years. An internationally coordinated approach to structural change would indeed be valuable and would, if properly designed, facilitate the task of macroeconomic management. These reforms should, in our view, include the activation of labour market policies as an important instrument of an economic policy oriented towards employment and growth.

# CONCLUDING SESSION



# What are the Lessons of the Conference? What is the Future Role of our Organizations?

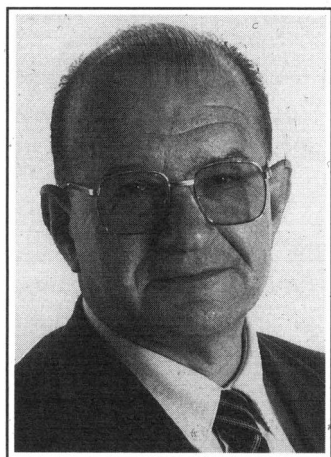


*Owen B Butler*  
Retired Chairman  
Procter & Gamble Company,  
Chairman  
CED Board of Trustees

I would like to start by thanking SNS for putting this conference together. I think that you have done an out-standing job of planning the conference, and attracting speakers who were both comprehensive and challenging. You said at the outset that we are in a period of rapid change, and I think CED and the counterpart organizations have to take the responsibility to persuade our own countries to seize this change as an opportunity rather than to see it as a threat. It is clear from the discussions the last couple of days that the global market is something that exists. We can like it or not like it, but it is there, and it will be there whether we like it or not. Any of us, as individual nations, can attempt to barricade ourselves against the global market or can attempt again to take advantage of it, but we cannot change the fact that it is there. The emergence of this global market for goods, services

and capital represents an immense opportunity to improve the lives of all the people in both the developed and the undeveloped countries. But it will do that only if we seize it as an opportunity. We need to recognize that each nation in this global economy, is going to attempt to act in its own self-interest, and there is nothing wrong with that. I think what we in CED will try to do in the United States – and what I hope our counterpart organizations will do – is try to see that the self-interest in which our nation acts is an enlightened self-interest. I think that we have a particular opportunity – and a particular obligation – to do that, because CED – and I think most of the counterpart organizations – are almost solely in a position to avoid the pitfalls that other elements within our society face. We do not stand for elective office, we are not politicians, therefore we can afford to tell the unpleasant truth when necessary. As opposed to our elected officials, I think earlier this week we heard discussion of the US trade bill, which is a kind of classic example of the problems politicians face with this issue. As you heard, the trade bill does not really contain anything new, and yet the great majority of both our congressmen and our senators felt it necessary to vote for that bill. A president who has been a staunch advocate of free trade, found it necessary to sign it, for symbolic reasons. None of them wanted to stand up and simply tell the truth as it is. We in CED are not an industrial association, and therefore we do not have to try to represent a particular industry's point of view, which might be in favour of some kind of protectionism, but rather can express a social economic point of view in favour of free trade. Moreover, we are not negotiators. Again, we at CED are free to urge upon our nation the things that we need to do as opposed to negotiators, who so often have to be taking a position about what others ought to do to solve our problem. And we have the ability and the influence to have some impact on the public policies which our countries will adapt. I think all of us need to recognize the importance of Mr Ishihara's comment that the strength of the Japanese companies on the global market is based on the severity of their competition at home. And having been both a participant and an observer of the Japanese economy for some years, I suggest that he is telling the truth: it is a harsh, and severely competitive economy. I think that this, in fact, is one of the great sources of the strength of their corporations. I think all of us need to be reminding our societies that if we protect ourselves from competition, then in doing so we weaken ourselves. I am delighted with this follow up to the meaning that all the

cooperating associations had in Paris. I hope we will continue to see this kind of communication among these organizations in the years ahead.



*Michel Drancourt*

President, Institut  
de l'Entreprise IDEP

The title of our conference so superbly organized by our friends of SNS, is "One Global Market". They also had the excellent idea to propose for this evening's entertainment "the Creation" by Joseph Haydn. Should we see a symbolism in this choice? A few years ago, we would have been talking about the international market. So we can say today, that we have achieved some progress, at least in terminology. Fortunately, at the same time trade has continued to grow. We all know that to gain an extra percentage point in world growth national product, we must increase trade by 1,5 or 2 per cent. Let us hope we can keep moving in that direction. I think the development of trade, the prerequisite for the pursuit of growth and prosperity, was for many years granted by the power and the authority of the United States. Nowadays we are living in an era in which leaders are no longer in a position to oversee the orderly functioning of the free market economy. All the nations are exerting their influence, and voicing their ambitions. There are new economic powers, notably Japan, unable to take over the role of a leader who has, moreover, no claims for preeminence. Now Europe, The Common Market, at present without a genuine common

political will, capable of assuming the mantle of leadership from America, or of helping the United States to cover the strength partially lost. Consequently, in order to continue the liberalization of trade, we must in the future rely on concerted action between the countries, fully aware of the existence of international solidarity. However, such concerted efforts will not prove effective if business organizations fail to unite their efforts, in order to get the respective governments to uphold a climate of freedom which will help to foster the tremendous growth and prosperity that we have had since World War Two. Business organizations must, therefore, act upon the social and political environment so that the determination to achieve an open international market will continue to prevail over the temptations of protectionism. Likewise, they must continue to push forward the ideas, and proposals in favour of free enterprise. Now, what is the future role of our organization? As regards the future, the Institut de l'Enterprise is convinced that we must continue, like you, meeting together on occasions like this our present conference. The bonds of friendship between us are just as important as the studies and actions we accomplish. For the freedom we are looking forward to getting together in 1989 in Australia, probably 1990 somewhere in Europe – perhaps in Strasbourgh, in 1991 I hope in Tokyo, in 1992 in the United States, and perhaps in 1993 in Brussels, to see if we have really moved ahead in building a new world entity called Europe. Indeed, in order to give you a better picture of concern, I shall mention a few words about our own activities. Our operation takes place mainly in France, of course, but within the European framework we are confronted fundamentally with two challenges. Firstly, how to get employees really involved and active in the implementation of the policies for promoting competitiveness decided by management. What must we do to win support for free enterprise and free trade, despite the attendant difficulties concerning employment and purchasing power. This over riding concern underscores the paramount importance we attach to effective human resource management. Secondly, upholding the spirits of openness – prosperity depends in parts on the actions of the European Community. Of course, the attitude of the United States and Japan are key factors. None the less, according to whether Europe will be a strong political and economic entity, a loose free trade area, it will – or will not – be in a position to influence world-wide decision-making. What sort of Europe do we want? Numerous surveys have been conducted on how the politicians

see Europe. They have focused on the role of the commission in Brussels, and on the macro-economic profile of Europe. At the Institut de l'Enterprise we have decided to embark on a broad study, on how European business – especially German business leaders – are preparing the future firms, and also on their perception of the impending single market. We want to explore their approach to the problem of unemployment, which – as we know only too well – plague many European companies. We would like to learn their views on free trade, as well as on the localisation of business. We are anxious to gather the opinions regarding the most appropriate ways to overcome our European weakness. For example, compared to the Japanese, in order to get a foothold in sectors such as electronic components Europe spends ten times the amount on research for 10 times less its actual achievement. Is this really acceptable? Quite obviously market efficiency will require a common European base with public and private laboratories, working together along the lines of the recently initiated ESPRIT program. To put it differently, do corporate leaders believe that a little more Europe can contribute to the development of their companies, as well as to strengthening the role of the old continent in international trade negotiations? In short, what content do European managers put into their concept of Europe? We are going to put to them all these questions in our comprehensive two-years survey, the goal being to publish our findings sometimes during 1990. In the meantime, I express the hope that the prosperity over the recent months, will not give way to further period of turbulence because in this way the forces of protectionism and interventionist government, will no doubt regain the ground in recent years.



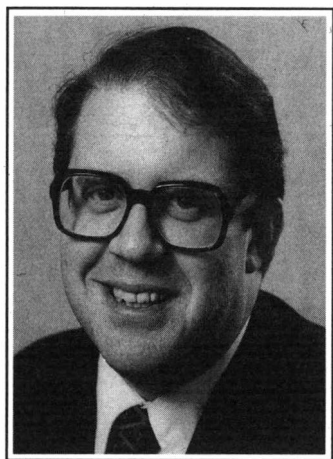
*Takashi Ishihara*

Chairman, Nissan Motor Co Ltd,  
Chairman Keizai Dokyukai  
Board of Trustees

I would like to share with you some of my thoughts regarding the theme of this conference, One global market. Technological progress and steps being taken to stimulate the economy are working to create more integrated markets, for goods, services, capital, and labour. It seems certain that we will see the growth of One global market in the years ahead. Yet, at the same time, other moves are also under way, such as the free trade agreement between the United States and Canada, and the integration of the EC market planned for 1992. There is some concern that if the wrong steps are taken, the world economy might be divided into closed blocks or regions, such as what happened during the 1930s. Some warnings are also being voiced today about the newly industrializing economies of Asia. These countries have made remarkable steps in recent years, and their impact on the world economy is continually growing. Meanwhile, effective solutions to the problem of accumulated debt in some countries, have been delayed, although this has been an issue of concern for several years now. There is the impression today that these countries are being left behind in terms of economic development. It is my opinion that the responsibility for the creating one global market rests on the shoulders of the world's leading powers, including Japan, the United States, and the European nations. It also rests on the shoulders of the corporate leaders of these countries. I feel it is important that steps be taken to keep the world economy, from being divided into regions or blocs. Efforts should also be made to incorporate the dynamic energy of the newly industrializing economies

of Asia. Programmes should be implemented to allow the developing countries, now suffering under accumulated debts, to be brought into a cycle of growth and development and thereby play a larger role in the world economy. If these actions are taken, I think we can create one global market, that will be supported by diversity and dynamic vitality. This type of global market will require the establishment of at least two principles. The first principle is that the competitive conditions which provide the bases for corporate activity, should be made equal for all companies in our countries, to the fullest extent possible. The second principle is that under these equal competitive conditions, companies in all countries should engage in fair competition based on international business rules. In order to establish these two principles, efforts will have to be made in three areas: in the area of policy in each country, in corporate behavior and in international cooperation among countries. In the area of policy it is hoped that each country will keep in mind the Uruguay round, and return to the original spirit under which Gatt has been established. In this connection, each country should strive to create a multi-lateral trade system that allows all countries to operate freely and without any discrimination. Secondly, countries should make an all-out effort to open their markets and ease regulations. It is essential that each country opens its own markets, wider to other countries of the world. Thirdly as countries open up their markets they should also take steps to strengthen the competitiveness of their own industries. This will require continual promotion of structural adjustments, in their markets and industries in order to maintain international levels of competitiveness. It will also require the adoption of policies designed to restructure their economies, to match a constantly changing world. Next, in the area of corporate behavior, a global market will create many new business opportunities for private enterprise. On the other hand, it will also expose companies to severe competition and intensify various types of friction. I think it is important, therefore, that a principle of self-responsibility be established. Under this principle, companies will engage in fair competition and assume the responsibility for the outcome. What this means is that, when confronted with this conflict, or competition, in which survival is at stake, companies should not be so quick to rely on the help of government or regulations. Rather they should use their own strength to constantly change their corporate constitution and behaviour. This will enable them to develop a competitive capability and capacity for

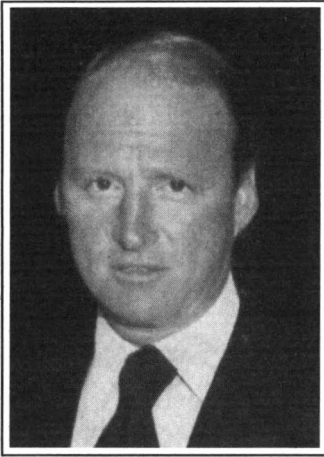
action required by the times. In short, this means that countries should make a constant effort towards self-reform. In addition to these efforts made in the area of government policy and corporate behaviour, cooperative action is also needed, among the nations of the international community. Cooperation is needed to stabilize exchange rates and to coordinate macroeconomic policy. It is also needed to promote the flow of capital back to countries suffering from accumulated debts and to coordinate programmes of technical cooperation to support their economic development. It must not be forgotten that policy cooperation among Japan, the United States, and the European nations, is an indispensable condition for the development of one global market. Finally, I would like to stress once again, that this international conference provided an excellent opportunity for all participants to think about the issues facing corporate leaders today and the action that should be taken by our organisations. By going beyond our differences of opinion, we were able to deepen our mutual understanding. By way of closing, I would like to thank everyone at SNS once again for giving us this valuable opportunity.



*Marcus Storch*  
President and CEO, AGA,  
Chairman, SNS Executive Board

It is difficult being in the last round. Let me first say thank you. The lessons from this conference I think were pointed out very well. The ambition level of the topics should not be too high, permitting discus-

sions, and perhaps some free time for discussion. Let me devote some more time to the second question. What is the future role of our organization? Firstly ask ourselves, do we mean together or separately. I think we are moving towards one global market, with difficulties. These are temporary problems, I am sure. The communication between independent organizations, such as ours, needs to be strengthened. There are very few independent organizations. Meetings is one form. However, when we do talk about one global market, maybe we should not forget the importance of the global politicians. We need independent organizations at a local level. The national element is always there and should not be suppressed in those discussions. I also think the free form that we have is a great asset. We should not try to formalise it, or to trade committees and things like that. We should let the different organisations, with their executive management, try and work out forms for how to improve it. We should also choose at least parts of programmes when we do it, that emphasizes the internal independence. That would both attract and force us ourselves to do this work. I think organizations of our form play a very important role today. They will play an even more important role tomorrow, because there will be less and less free forces to state their opinions in a more controlled and developed market so let us keep our free form in an active way as we do today and thereby contribute to creating one global market.



*Dr Konrad O M Westrick*

Proprietor of Westrick International  
Management Consultants, Bologna/  
Bonn  
CEPES Executive Board

After these comprehensive conclusions, may I be permitted now to return to the main argument, but just answer briefly two precise questions that you put to us. What are the lessons of this conference? Let me divide my comments under the headings of technical and general. Firstly, my compliments for the brilliant idea of organising after this conference, a corporate visit programme, which is, to my mind, an excellent initiative, in order to promote knowledge and a person to person exchange of view. I think this kind of exchange and communication should take place more frequently. Discussion indeed was virtually impossible for time reasons or/and diplomacy or psychological reasons. Nevertheless we think it is not only desirable, but very vital, to make this kind of meeting more effective. This applies to both academic disputes such as for instance concerning Professor Lindbeck as well as to more down to earth, matter such as the question of Turkey's entrance or non-entrance to the EEC. I would therefore perhaps distinguish between a declaration meeting, which may be multinational, and of a more general informative and intentional character, and/or a discussion meeting that maybe either bi-or tri-national, or organized in workshops with one or two lectures permitting and provoking highly intensive discussions. Our communication still seems to be rather schematic. There is one statement, one conviction, and one determination to defend this stand-point. One is rather aggressive in conducting an attack while being very sensible when attacked. Let me therefore suggest fewer declarations, more discussion, more tolerance, and the wil-

lingness to weigh and contemplate the opinion of others, using this not so much as a threat to my own point, but as a chance to honestly verify the soundness of my own position.

Question No. 2, what is the future role of our organizations? Generally speaking, I see our role as a catalyst in globalising markets. To guarantee existing differences and nevertheless assure a basic harmony between different characters, habits, traditions, convictions, mentalities, ways of doing things, and so on. "The pluribus unum", and this is not European. The active promotion of some common ideals of political and economical ethics, which offered an effective platform for people who try to develop their businesses under similar conditions. We should not play the role of others, of professional associations, of political groups, of diplomatic representations, of official conventions etc. Our self-understanding is that of an independent group of people with a minimum of economical, political and ethical common denominators. Thus allowing immediate communication, competent in different fields of life and business, able to analyse and explain their own position and understand and consider the position of others. As we are not hindered by constraints, there is all the more, "raison d'être", for our organizations. We are accordingly in a good position to go ahead and supply straight and reliable information, as far as our countries and our policies are concerned. We are in significant positions in our different countries to receive and deposit, in an efficient way, information and to influence things in that direction. Our role, as I see it, is to monitor integration in a different dimension. Anonymous institutions often get stuck in confrontation, whereas single, motivated and motivating persons can solve problems of mutual understanding.

This is my last point, as we do not have to excel, as an institution, we can and should concentrate on developing our skills as personal catalysts, exercising a typical communication pattern, of acting and reacting, as I said, not in a schematic, chauvenistic or declaratory way, but listening honestly to our discussion partner and understand him. If we do not really understand each other, we will not be accepted. If we are not accepted, we cannot be an integrating factor in a globalising market which indeed is our role and duty.

Mr Chairman, what is a final statement worth, if it does not end with a sincere, and hearty thanks to you, on behalf of the German delegation CEPES, I would like to extend these thanks to the former chairman and founding father, Mr Browaldh, to Baron Stig Ramel, to you Mr Chair-

man, to the executive director, Mr Söderström, and to the director of the programme, Mr Eliasson and to all the ladies and gentlemen who so effectively and gently contributed to organizing this event. May I conclude saying, SNS and Sweden merit our thanks for having contributed to one global market.

# Biographical Information on the Principal Speakers

**Percy Barnevik.** Born 1941 in Simrishamn, Sweden. Stockholm School of Economics, MBA 1964. Stanford University 1965–66. The Johnson Group 1966–69. Group Controller, Sandvik 1969–75. President of Sandvik in the USA 1975–79. Executive Vice President, Sandvik AB 1979–80. President and Chief Executive Officer, ASEA 1980–87. 1988– President and Chief Executive Officer of Asea Brown Boveri Ltd, Zürich, Switzerland.

**Yoshitoki Chino.** Born 1923. Graduated from Keio University, Faculty of Law in 1946. Managing Director of Daiwa Securities Co Ltd 1966. Senior Managing Director 1970. Chairman 1982. Counsellor of Bank of Japan. Chairman of Association of Tokyo Stock Exchange Regular Members. Member of Directors of Japan Securities Dealers Association. Member Governor of Tokyo Stock Exchange.

**Kjell-Olof Feldt.** Born 1931 in Holmsund, Sweden. Fil lic (PhD) in economics 1967. Member of Parliament since 1971 for the county of Dalecarlia. Member of the Executive Board of the Social Democratic Party since 1978 and the Executive Committee since 1981. Minister of Finance from January 1983.

**Gerhard Fels.** Born 1939, Baumholder, Rheinland-Pfalz, Federal Republic of Germany. Professor of Economics. Director and member of the Presidium, Institut der deutschen Wirtschaft, Köln. Director and Professor, Vice President Institut für Weltwirtschaft an der Universität Kiel 1969–83. Member of the German Export Council on Overall Economic Development 1976–82. Member of the Committee for Development Planning of the United Nations 1978–82.

**Alejandro Fernandez de Araoz y Marañón.** Born 1937, San Sebastian, Spain. Master of Laws and Bachelor of Economics, University of Mad-

rid 1959. Executive Director Banco Internacional de Comercio 1967. Chairman of Banco Internacional de Comercio 1970–88.

**Isaiah Frank**, is William L Clayton Professor of International Economics at The John Hopkins University School of Advanced International Studies. PhD in economics from Columbia University. In 1945 he joined the State Department. He was Director of the Office of International Trade Policy and then Director of the Office of International Financial and Development Affairs before his appointment as Deputy Assistant Secretary. He has served as Executive Director of the President's Commission on International Trade and Investment Policy. Since 1975 he has been Chairman of the State Department's Advisory Committee on International Investment, Technology, and Development.

**Henri Froment-Meurice**. Born 1923 in Paris. French ambassador. Certificate from l'Ecole Libre des Sciences Politiques, Licencié ès-lettres, ENA. Deputy Director of Europe Orientale 1960–63, Director of Asie-Océanic 1969–74, Director of Business and Finance Economics 1975–79. Ambassador in Moscow 1979–81 and in Bonn 1982–83. Councillor to the President of Banque Paribas since 1985.

**Pentti J K Kouri**. Born in Finland. Graduated from Helsinki University 1970. He received his doctorate in economics from Massachusetts Institute of Technology in 1975. Research Professor of Economics, New York University. Chairman, Kouri Capital. Professor Kouri is the founding partner with Mr Juhani Lipsanen of Kouri Capital, the leading privately held merchant banking firm in Finland with activities in the United States and Europe. He has previously taught at Yale, Stanford, Stockholm and Helsinki Universities. He has worked as an economist at the International Monetary Fund and, in 1978, was a member of the Brookings Panel on Economic Activity. In 1986–87 he was a visiting professor at Columbia University.

**Assar Lindbeck**. Professor of International Economics, University of Stockholm. Wesley Clair Michell Research Professor, Columbia University 1968–69. Ford Rotating Research Professor, Berkeley 1969. National University of Australia, Canberra summer 1970. Irving Fisher Visiting Professor, Yale University 1976–77. Hoover Institution summer 1977. Simon Fraser University summer 1981. World Bank

1986–87. Member of the Royal Swedish Academy of Engineering Sciences 1970, the Royal Academy of Sciences 1971, the Finnish Academy of Sciences 1972, the Danish Academy of Sciences, Honorary Member of the American Economic Association and Member of the Committee for Prize in Economic Science in Memory of Alfred Nobel 1969–, Chairman 1980–.

**John Nieuwenhuysen.** PhD from the London School of Economics. Currently Reader in Economics at the University of Melbourne, and Research Director for the Committee for Economic Development of Australia (CEDA). He has previously worked with the International Labour Office, Geneva, the British Department of Trade and Industry, London, and the Universities of Pittsburgh and Natal. In recent years, Dr Nieuwenhuysen served as Chairman of a review of taxation in Victoria, and as Chairman of a review of Victoria's Liquor Control Act. His many publications range across competition, wages and prices policy, to the economic status of Australian Aboriginals, and professions in the market place.

**Sir William Rylie.** Executive Vice President of the International Finance Corporation, an affiliate of the World Bank. Sir William came to the IFC in 1984. He was British Executive Director of the World Bank, of the IFC and of the International Monetary Fund from 1975 to 1979 and Permanent Secretary of the British Overseas Development Administration 1982–84. 1975–79 he was also Economic Minister at the British Embassy in Washington, D.C. For the two ensuing years he was Second Permanent Secretary at the British Treasury. He has held various posts in the Treasury in London, in the British Colonial Office, and with the Government of Uganda in the 1950s.

**Sven H Salén.** C.B.E. Born 1939. LL.B. University of Stockholm 1966. Active in the Salén Group since 1966. Chairman Salénia AB (family-owned). Managing Director Sven Salén AB (family-owned). Chairman Swedish Shipowners Association 1977–81. Vice President Intertanko 1977–82. Chairman SNS – Center for Business and Policy Studies 1978–82. Chairman SNS Board of Trustees 1983–. Director United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited 1975–88. Director Bilspedition AB 1985–. Director John I Jacobs PLC, London 1986–.

**Hans Tson Söderström.** PhD, Stockholm School of Economics 1974. Senior fellow, Institute for International Economic Studies, University of Stockholm 1971–84 (Associate Director 1979–84). Executive Director, SNS, 1985–. Visiting Scholar, Princeton and Stanford Universities 1975–76. Visiting Research Professor, Board of Governors of the Federal Reserve System 1976. Director SEB-Invest AB 1980–85, Swedish Shareholders Association 1984–, Montagu Fondkommission 1986–88, Stockholm Stock Exchange 1987–, Sven Hagströmer Fondkommission 1989–.

**Zygmunt J A Tyszkiewicz.** Born 1934 in Warsaw, Poland. British since 1955, Cambridge University 1952–55 BA (Hons) Modern Languages. Joined Shell International Petroleum Ltd in London 1957. Managing Director Shell and BP Tanzania Ltd 1970–73. Bureau Shell d’Outre Mer, Paris. Director 1973–76. Billiton International Metals, The Hague (Shell’s metals subsidiary). Development Manager 1976–79. Shell Co. (Hellas) Ltd, Athens General Manager 1979–85. Appointed Secretary-General of UNICE 1985–.

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COMMITTEE FOR ECONOMIC DEVELOPMENT OF AUSTRALIA

Institut der deutschen Wirtschaft  
Geschäftsführung



CED

Committee for Economic Development

CEPES

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KEIZAI DOYUKAI  
経済同友会



POLICY STUDIES INSTITUTE



Center for Business and Policy Studies

CE	Circulo de Empresarios. Spain
CED	Committee for Economic Development. USA
CEDA	Committee for Economic Development of Australia
CEPES	Vereinigung für Wirtschaftlichen Fortschritt. Federal Republic of Germany
IDEP	Institut de l'Entreprise. France
IW	Institut der deutschen Wirtschaft. Federal Republic of Germany
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PSI	Policy Studies Institute. Great Britain
SNS	Center for Business and Policy Studies. Sweden















# One Global Market

Effects of the Internationalization of Markets for Goods,  
Capital and Labor on the Corporation and Public Policy.

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Sweden, 30 - 31 August, 1988.

## Speakers:

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Yoshitoki Chino	Assar Lindbeck
Alejandro Fernandez de Araoz	John Niewenhuysen
Kjell-Olof Feldt	Sir William Ryrie
Gerhard Fels	Sven H Salén
Isaiah Frank	Hans Tson Söderström
Henri Froment-Maurice	Zygmunt Tyszkiewicz

## Comments by:

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Tore Browaldh	Takashi Ishihara
Owen B Butler	Vsevolod Dmitrieff
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