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SUMMARY

A New Era of Globalization

It has been argued that the current globalization trend is only a continuation of the developments occurring before the First World. In our opinion, however, the current stage is unique. *First*, the number of countries participating in it is larger. *Second*, globalization was not previously based on widely accepted and implemented policies towards free trade and unrestricted capital movements. *Third*, developments in information and communication technologies have opened new ways for conducting business on a world scale. Thus, by *globalization* we refer to the latest stage of internationalization that started during the 1980s; this new phase was initiated by widespread deregulation of financial markets and competitive policies as well as by advances in information and communication technology (ICT).¹

Foreign direct investment (FDI) and multinational enterprises (MNEs) have a central role in the globalization process. MNEs already control three-fourths of world commodity trade and account for three-fourths of all industrial R&D in the OECD countries.

Finnish companies compete in global markets. So does Finland, as a nation, although in a different manner. A firm's ultimate objective is to maximize a discounted stream of profits. A nation's objective is to maximize the welfare of current and future citizens. Global competitiveness at the national level centers around the question of *how can a country be an attractive home base for MNEs' high value-added activities*.

Global Competitiveness

Currently, most firms in the world are rooted to some national business environment. While this will continue to be the case for the majority of companies in the near future, economic power is shifting towards MNEs without clear national identities.

In the global environment, a broad range of factors has to be mobilized in order to be competitive; all of these skills may not be available locally. As the relative importance of transportation and communication costs decreases, firms spread their value-added activities across the globe to places that offer the best possible environment for a specific function. Also, shorter innovation times, faster product cycles, and escalating development costs call for globally dispersed business activities.

Traditional indicators of competitiveness, calculated by and large on a national basis, are losing their explanatory power. Thus, we have to reexamine the concept of national competitiveness. In our opinion, the *global competitiveness of a nation* can be defined as follows:

The ability of a nation-state to continuously attract high value-added activities of private enterprises worldwide in such a way that all factors of production are fully employed, earn high returns, and long-term external balance of the country is maintained. This is reached on

¹ Globalization of businesses and rapid advances in ICTs are interrelated. On the one hand, the information and communication technologies make it possible to effectively decentralize and control the global operations of multinational enterprises (MNEs) – on the other hand, global competition is a major driving force behind technological innovation and rapid diffusion of ICT.

a sustainable basis by offering appropriate framework conditions and sufficient pools of advanced factors of production.

We will emphasize over and over again that firms compete in markets, and thus competitiveness is essentially a firm-level concept. As can be inferred from our definition, competitiveness at the national level is realized through firms.

World Trends in Globalization

We consider four facets of globalization: (1.) exports and imports, (2.) foreign direct investment, (3.) capital transfers, and (4.) technology transfer.

Exports

The share of world exports as a percentage of GDP has grown quite steadily in the post-war era. At the same time the world economy has expanded; thus the volume of world merchandise trade has grown by 1,500% from 1950 to 1996.

Capital Flows

The foreign exchange market is the most globalized part of world financial markets. The average daily global turnover in the foreign exchange market has grown from \$200 billion in the mid-1980s to around \$1.2 trillion in the mid-1990s. The average *daily* foreign exchange trading turnover is thus approximately 20% of the value of *annual* world exports of goods and services.

Global trading in equities is considerably smaller than trading on bond or foreign exchange markets: the average total daily turnover of all the world's stock exchanges in the early 1990s was only about 10–13% of average daily trading volume of government bonds. Budget deficits in many countries explain this phenomenon.

The foreign exchange market is fully globalized. Bond and derivatives markets are rapidly globalizing. The globalization of equities markets has also started to intensify during the 1990s.

Technology

Most countries in the world have significantly increased their reliance on imported technology. The United States and Sweden, among others, are important sources of this imported technology.

A vast majority of technology flows actually takes place via foreign affiliates of MNEs. Another way to transfer technology is a technology or 'strategic' alliance; 29% of all inter-company alliances are technology-based.

Foreign Direct Investment

Worldwide FDI flows set new records in 1996: inflows increased by 10% to \$349 billion, while outflows rose by 2% to \$347 billion. The driving forces of expanding foreign direct investment are as follows:

- *Technology.* ICT has made it possible to process and transmit huge quantities of information, as well as to manage the daily activities of a widely spread corporate network. Advances in transportation have facilitated the flow of goods and people.
- *Policies.* Trade has been liberalized in the post-war era.
- *International production.* International production has become an integral part of the world economy.

Finnish Globalization Trends

Exports

While traditional forest industry related products still dominate Finnish exports, the shift towards more knowledge intensive products has been remarkable in recent years. In the 1990s, the value of high-tech exports has surpassed the value of imports. The so-called 'high-tech' products comprised a good 6% of Finnish exports in 1990; by the mid-1990s the figure had more than doubled.²

Capital Flows

In the first half of the 1990s almost all of the foreign investment in Finnish securities was in bonds. Foreign investment in Finnish shares began to increase in 1993, when the remaining restrictions on foreign ownership were abolished. Since then, foreign investment in Finnish shares has increased rapidly. Currently, the values of foreigners' share and bond portfolios are nearly equal. The share of foreign ownership in the Helsinki Stock Exchange is the highest in Europe, approximately half of the total market value. Foreign investors are mainly institutional investors, such as mutual and pension funds. They typically diversify their portfolios worldwide.

Until the mid-1990s Finnish investment in foreign securities was modest. Since then, investments both in foreign bonds and equities have increased quite rapidly. Investors have mainly been financial institutions and insurance companies. However, the scale of Finnish investment in foreign securities is still quite insignificant compared to foreign investment in Finnish securities: in the beginning of 1998, the value of Finns' portfolio stock abroad was only one-seventh of the stock of foreigners' portfolio of Finnish stocks and bonds.

Technology

Internationalization of Finnish firms' R&D activities has followed the globalization trends of other functions, such as production and marketing. It is estimated that approximately one-fifth of Finnish manufacturing companies' R&D is already done abroad.

Foreign Direct Investment

At the end of the 1970s, foreign direct investment (FDI) outflows of Finnish companies averaged less than FIM 500 million annually: mainly sales offices were established. It was not until the early 1980s that Finns started to acquire major productive assets abroad.

There are several explanations for the recent increase in *inward FDI flows*. The removal of the remaining restrictions on foreign ownership in 1993 made Finland a more potential destination for foreign firms' direct (as well as portfolio) investments. Furthermore, since the technological level of Finnish companies has improved quite rapidly, acquiring one of the existing companies has become a more attractive option. The deep recession in the early 1990s paved the way for foreign firms' to enter Finland: companies with sound business operations ran into financial difficulties and could be acquired at a reasonable

² In 1996 nearly 80% of Finnish high-tech exports originated from the telecommunications cluster.

price. Also, the depreciation of the Markka, Finnish membership in the EU, as well as the growth prospects of the Russian and Baltic markets have helped the matter.

There is a clear imbalance between inward and outward investment: in 1997, for example, the outward FDI stock was two times greater than the inward stock. One explanation for the imbalance is that Finnish firms have invested abroad mostly in manufacturing companies, whereas foreign companies have invested in Finland primarily in trade and services sectors. The average size of acquisitions may also have been larger in outward FDI.

The Finnish Perspective on Firm-Level Globalization

Finnish Companies Abroad

Following the surge in global foreign direct investment flows, foreign acquisitions of Finnish firms accelerated in the late 1980s. After a short break in the early 1990s, this trend of rapid globalization has continued in 1994–8.

Foreign-Owned Firms in Finland

In spring 1998 there were about 1,700 foreign-owned companies in Finland. This is less than one percent of all the firms in the country. However, the foreign-owned companies' share of value added and employment was over ten percent. This implies that foreign-owned firms are, on average, larger than Finnish-owned firms. In fact, one-third of the 500 largest firms in Finland are controlled by foreign parent companies.

Globalization and Public Policy

Policy Guidelines

Industrial policy aims at improving framework conditions or the operational environment of firms. Direct subsidies are seen as harmful in the long run, since competition is distorted. Governments do not have superior knowledge over private firms in foreseeing the future success of businesses.

Industrial policies nevertheless have an important role to play. The main goals of the policies are, on the one hand, to ensure the efficient functioning of the market and, on the other hand, to create advanced and specialized factors of production. Industrial policies are taking a broad scope in modern policy thinking: educational, trade, energy, environmental, and competition policies overlap, to a large extent, the areas of industrial policies.

In the current situation, where countries compete for MNEs value-added activities, industrial policies are becoming competitiveness policies. Governments are aiming at creating attractive locations for internationally competitive firms by developing high level technological infrastructures and other internationally immobile (created) factors of production.

Concluding Remarks

Globalization – Just a Zero-Sum Game?

It has been argued that globalization will, among other things, increase social and economic inequality, shift economic and political power from democratically elected decision makers to MNEs, and put downward pressure on hourly wages in the industrialized countries as competition from third world countries tightens. Many observers make the pessimistic conclusion that, as a consequence, worldwide welfare

deteriorates and a handful of large companies will rule the world (see, e.g., Korten, 1997).

Regardless of whether one accepts the pessimistic scenario or not, “The general consensus is that the process of globalisation of economic activity is irreversible.” (OECD, 1997c, p. 27). If we try to isolate ourselves from worldwide trends and their effects, the consequences will almost surely be detrimental.

In reality, global annual GDP continues to grow; freer trade and market integration has generally improved welfare. While the benefits, in terms of faster economic growth for instance, are unevenly distributed across countries, there is little evidence on the clear adverse effects of globalization (see Bhagwati, 1998).

This is not to say that there would not have been profound, and sometimes unwelcome, labor market changes among the industrialized countries. Labor demand has shifted towards ‘high skill’ professions, which is also reflected in relative wages; since the 1970s real earnings of low skill workers have in fact *decreased* (for U.S. evidence see Slaughter & Swagel, 1997; Haskel & Slaughter, 1998). In Europe the changing labor demands have been manifested by the high unemployment rates and increased income inequality³ among low-skill workers.

We argue that domestic factors explain observed problems within a country much more powerfully than global ones. We have also noted that *a priori* one should expect to gain rather than to lose as a consequence of globalization. Fears of a crumbling domestic capital stock, job loss, and a deteriorating standard of living are perhaps exaggerated. Furthermore, we are in control here: “Factor employment and hence job creation, and factor income and hence living standard levels, generated by domestic business sectors are determined by firms’ competitive achievements.” (OECD, 1996d, p. 13).

Cross-Border Capital Flows, MNEs, and Employment – Are Jobs Being Exported?

Still-fragmented evidence would seem to suggest that outward foreign direct investment promotes activities in the home base. At least in the Finnish case the effects of globalization have been positive. It seems, however, that the complementarity of foreign and domestic investment is becoming less obvious. Cross-border horizontal expansion has led to a situation where intra-firm plants in various countries compete rather than cooperate with each other. In a multiplant firm production can easily be shifted from one country to another as relative costs change. Thus, issues of relative costs cannot be ignored even though technology plays a major role in the globalization process.

Foreign Ownership in Finland – Selling the Crown Jewels & Losing Control?

As the analysis of investment stocks above reveals, Finland has attracted relatively little foreign investments compared to our investment abroad. In fact, the outward stock is over twice as high as the inward one. Despite the growth of inward investment in the 1990s, the imbalance between the two stocks continues to grow, i.e., the outward investments of Finnish companies have expanded even more rapidly. Yet it should be noted that already one-third of the top 500 companies are foreign controlled. Large and/or technology-intensive companies have attracted foreign capital the most.

³ With the exception of the U.K.

Portfolio investments in Finland have exploded in the 1990s. Currently, foreign parties hold half of the market value at the Helsinki Stock Exchange.

Cross-border capital flows have aroused discussion and fears about the diminishing national control. The research suggests, however, that the free flow of capital promotes economic efficiency and functioning of capital markets. Thus the effects are mainly beneficial.

Despite the many benefits of cross-border capital flows, there are also some potential drawbacks. On the policy front, the range of possible tools has narrowed considerably. In part, 'market forces' have taken over policy-making, i.e., in the making of public policy the consequences on the capital market have to be kept in mind. Furthermore, a high degree of foreign ownership may decrease the risk tolerance and increase volatility of a small open economy.

Finland in Global Competition – Strengths and Weaknesses

Finnish specialization is clearly shifting towards knowledge-intensive high-tech branches, away from the previous raw material, energy, and capital-intensive structure (Mäkinen, 1998).

In contrast to the trend in many other industrialized countries, Finnish gross domestic expenditure on R&D has grown throughout the 1990s. In particular, telecommunications technology has become one of the Finnish 'centers of excellence'.

Young generations in Finland are highly educated and the share of university graduates in science-related fields is quite high.

In Finland, it has been mainly domestic R&D, rather than imported technology, that has fuelled the growth of high-tech exports.

Some of the Finnish weaknesses in global competition are high income taxation, the low educational level of older generations, and high unemployment.

Highly progressive taxation and extensive unemployment benefits have reduced incentives to seek employment. Some unemployment has also been caused by technological development: while certain skills are in high demand, others have become obsolete. Low-skill employment in industry has decreased severely in the past few decades. In other industrialized countries, unlike in Finland, the service sector has absorbed a significant portion of vacant labor.

A Look Ahead

The competitive advantage of the Finnish economy and firms in it has changed significantly. The industrial structure has changed from slow growth industries towards knowledge-driven industries and industrial clusters. This has made the economy less dependent on the volatile world paper and basic metal markets.

The sensitivity of the Finnish economy to world market fluctuations has also been reduced as a consequence of the rapid internationalization of business, thanks to worldwide diversification of both exports and production.

From the perspective of a small open economy, the answer to the relative disadvantage of size is to specialize in niches and company networks; this is particularly true in the case of small- and medium-sized enterprises.

With its current structure, Finland is relatively well positioned to respond to the challenges of globalization. Recovery from the recession of the early 1990s showed that, despite doubts, there is sufficient macro-flexibility in labor markets and the economy as a whole (OECD, 1998b; Kiander & Vartia, 1998). The free movement of capital and EMU will, however, put the recently discovered flexibility to a new test. At that time, flexibility will be needed at a much more micro level. Individuals and firms must be ready to adapt swiftly to changes in their operating environment. Even if labor migration were to remain limited, rapid capital movements ensure that labor demand is responsive to changes in relative costs. Thus, curbing inflationary pressures remains one of the main goals of monetary and economic policy.