

9. Multinationals and the Development of the European Periphery. The case of Ireland and Greece.

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1. Introduction.

European Economy (EU) countries, at an intermediate level of development and with a clear urgency for fast economic growth and convergence with the rest of EU, need to assess the relative role of their domestic capital and weigh the costs and benefits arising out of the attraction of foreign capital.

New growth theories point to the possibilities for divergence rather than convergence arising out of the concentration of R&D and human capital in developed economies. New trade theories, as well as theories on foreign Direct Investment (FDIs), re-inforce this possibility. Increasing returns to scale and reduction in transport costs created industrial agglomerations, intensifying uneven regional development. Policy corollaries arising out of these theories need to be examined within the context of the EU. Regional Economic Integration influences growth through effects on patterns of trade and location of investment. The deeper integration within the EU arising out of the creation of the Single European Market (SEM) influenced both the viability of indigenous firms and the location of Multinational Enterprises (MNEs).

Ireland's membership of the EU, its early orientation towards an export-led growth and the creation of the preconditions for the successful attraction of MNEs paid dividends. Ireland experienced very fast rates of growth and almost converged with the EU15. Greece's experience over the same period was different. As a result of internal problems and an outflow of FDIs there was a widening divergence with the rest of the EU. However, MNEs intervention is not always a smooth one. It often creates tensions between indigenous and foreign capital, particularly if only the latter receives state assistance and linkages are weak. Further, MNEs' global strategies are often taken without reference to the interests of the host countries.

This paper will look first at some stylised facts of the two countries within the EU environment. It will then examine some theoretical issues concerning the requirements for growth, the location of industries according to new trade and FDI theories and their policy implications for the EU periphery. It will examine how the attraction of MNEs in

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both countries have always been linked with faster rates of growth. The final success however, depends on the linkages they have with local capital and the permanent effects they have on the restructuring of indigenous industries.

2. **Some stylised facts.**

The 1950s and early 1960s were the Golden Age of capitalism; it was the period when core Europe caught up with the USA, by experiencing consistent rates of growth above their historical trends. The EU periphery was not a part of this Fordist growth. It failed to experience fast industrialization and rising standards of living. For a short period in the late 1960s and early 1970s high levels of FDI were attracted in both economies, as a result of lower wages and (particularly in Greece) high domestic tariffs; they had an impact on rates of growth and incomes. The period from the mid 1980s is the crucial one. Internal reforms as well as the upcoming Single European Market led to an increasing flow of FDI into Ireland. Greece, besieged by internal problems and offering fewer locational advantages, as it is the most geographically peripheral EU country, experienced a serious divergence with respect to the rest of the EU. Advantages acquired in the 1970s, such as very high rates of growth, as the result of high levels of investment by MNEs, were lost. As these FDI failed to create any linkages with the Greek economy, their precipitous exodus in the 1980s had very serious consequences on the growth rates of the Greek economy.

Structural problems.

There are strong similarities between those two economies. Employment in the agricultural sector in both economies, despite its decline, it is still large and out of line with the rest of the EU (table 1). Further, these high levels are not the result of a buoyant agricultural sector, in fact productivity in this sector is low; instead they represent underemployment and lack of opportunities in other fields.

Table 1: Share of Employment in Agriculture

	1975	1985	1995
Ireland	22.4	16.5	12
Greece	33.2	28.9	20.4
EU 15	11.1	8.4	5.3

Source: European Commission 1997b

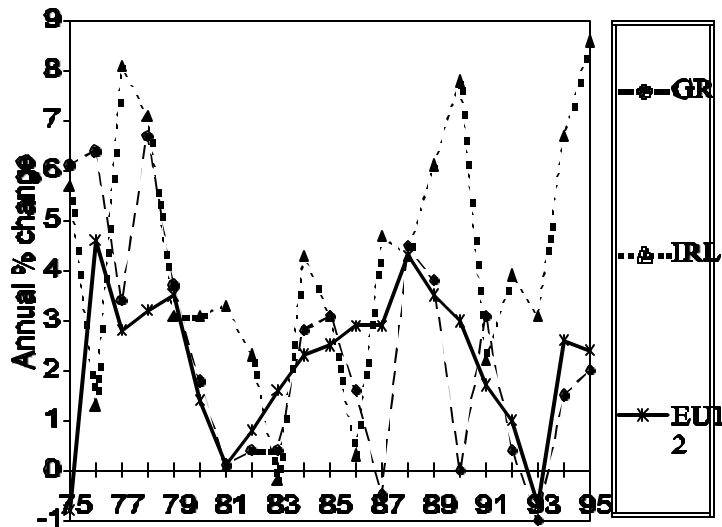
In terms of employment/ unemployment it is more difficult to draw any meaningful comparisons. Although both economies were for years besieged by high levels of unemployment, and as a result by high levels of migration, the situation now is changing. The traditionally high levels of Irish unemployment are coming down, as a result of improvements in the economy, while unemployment levels in Greece are rising. Further, differences in welfare systems between the two countries may also account for higher levels of underemployment in Greece. In Greece

“38 percent of...total agricultural employment is classified as unpaid family workers...Furthermore, in Greece the exceptionally high proportion of non-agricultural employment classified as employer/ self-employed (27 percent) or unpaid family worker (5 percent with 11 percent females so classified) also suggests underemployment” (EC 1997c: 11).

GDP per capita, as a measure of divergence from the core EU is in both cases below the EU average, although the situation in Ireland is improving. Starting from a similarly low level, high rates of growth, in excess of 8 percent, are leading to convergence of the Irish economy (Graph 1). In 1996, Ireland's GDP per capita at 18106 PPS was almost as high as the EU 12 (18154 PPS), while Greece's GDP at 11773 PPS is trailing behind all EU 15 countries (European Commissions 1997b).

Graph 1:

GDP. Annual % change. 1990 market prices.



Source: Eurostat

This is despite the fact that in 1997, in Ireland, GFCF at 15.7 percent of GDP not only is lower than in Greece (21.5 percent), but was among the lowest in EU15 (18.4 percent). (European Commission, 1997)

3. Aspects of economic growth and convergence.

In a neo-classical Solow type growth model with a Cobb-Douglas production function (showing constant returns and diminishing marginal productivity), it is shown that, in the long term, growth per person is independent of the rate of investment. Changes in technology affect investment decisions, but improvements in technology are not determined within the model, instead they are exogenously determined. As a result of capital accumulation and diminishing returns developed economies will experience slower rates of growth while countries at a low level of per capita income and capital labour ratios will grow faster. The main message to the developing countries was that

convergence was feasible and this did not require any specific policy intervention from Governments.

The seminal work of Romer (1986) shed doubts to this almost inevitably expected convergence between countries. Using a wider definition of capital, one which uses both physical and human capital plus Research and Development, it is argued that there are externalities arising out of the use of capital. Diminishing returns still exist, but only at firm level. Externalities to capital imply that divergence between countries will deepen. Deficiency in technology and human capital are thus intercepting the 'automatic' convergence between countries. An important corollary of this model is the importance of Government in influencing the rate of growth. While the neo-classical growth model does not provide scope for Government intervention, within an endogenous model Government, or EU, policies could influence the rate of growth by influencing the level of physical or human capital (education or R&D). As Baumol et al. (1994) argue whether convergence will take place or not depends on the level of human capital and the ability to assimilate and take advantage of modern technology. Countries satisfying these criteria are a part of the *convergence club* while for the very poor and backward countries possibilities for convergence do not apply.

The implication for countries at an intermediate level of development, such as Ireland or Greece, was that their prospects for development were subject to improvements in their physical and human capital. They had to reduce their existing technological deficit either by assisting their indigenous firms to invest and innovate or alternatively by encouraging the transfer of technology by Multinational Enterprises.

Given the weaknesses of their domestic capital the main means of transformation, innovation and growth became associated with operations of the EU and the transfer of capital and technology from the MNEs.

The role of the EU.

The EU 's influence spans over most of the developmental aspects of its member countries. Regional Economic integration has static and dynamic effects on both member states and trading partners. Trade creation and trade divergence is the most commonly cited effect of Customs Unions. The removal of tariffs influences relative costs and affects trade and production. However, dynamic effects of regional integration, such as the restructuring of production and the relocation of both domestic and multinational companies have the most significant impact on development and growth. Regional Economic Integration leads also to investment creation and investment diversion effect The movement of such investment is uncertain. Tariff removals removes some locational advantages in one region, while it creates advantages for others.

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The creation of the Single European Market (SEM) intensified economic integration and through the removal of tariffs, and most importantly, of non-tariff barriers, had a multifaceted effect on the peripheral EU countries. It affected their weak indigenous capital through the removal of tariff and non-tariff barriers, it influenced the location of MNEs and in parallel, it assisted their development through the availability and enhancement of the Community Structural Funds (CSF) and Cohesion Funds. The CSF increased from 15 percent of the EU budget in 1988 to 34 percent in 1996. As a percentage of GDP, the assistance to Greece increased, on an annual average basis, from 2.65 percent, in the 1989 - 93 period, to 3.67 percent in 1994 - 99, while the equivalent values for Ireland were 2.7 percent and 2.8 percent respectively. Further both economies benefited from the Common Agricultural Policy which contributed, on the average, another 0.4 percent to their GDPs.

The effects of the CSF were of a Keynesian (effects on aggregate demand) and supply - side (effects on the productive side of the economy) nature. In the case of Ireland, the effect of CSF 1989 - 93 on medium term growth of GDP was estimated to be 2.7 percent (Bradley et al. 1992), while the equivalent effect on Greece, for the same period, was estimated to be 1.85 percent (Capros and Karadeloglou, 1989). In the case of Greece, over 40 percent of CSF were directed towards the improvement of the infrastructure and 25 percent on training. In Ireland, the case was almost reversed. Expenditure on infrastructure absorbed 25 percent of the CSF and schemes on training and improvements of education 42 percent. This concentration of CSF on the improvement of human capital paid high dividends to the Irish economy.

These transfers, important as they were, did not fully address the problem of peripherality. In some cases, particularly in Greece, they were counterbalanced by negative dynamic effects, arising out of the creation of the SEM and its impact on the relocation and the restructuring of industries.

The Role of Multinational Enterprises.

Traditional trade theories were not concerned with the nationality of firms and their assumptions about perfect competition and constant returns to scale were inappropriate for analyzing the behaviour of MNEs. The 'New Trade Theories' together with theories on FDI did provide more satisfactory explanations about the location and activities of MNEs and their implication for the EU periphery.

The theory on FDI concentrates on the inter-nation, multi-plant operation from MNEs. Decisions of firms for overseas production was based on combination of advantages arising out of Ownership, Location and opportunities for Internalization (OLI) Dunning (1993). While Ownership and Internalization were factors internal to the companies, whose presence could enhance the profitability of the companies, locational advantages were external factors, arising out of bypassing tariff barriers and/or taking

advantage of cost differentials. Regional Economic Integration could alter the configuration of all these factors.

Countries with lower labour costs offered a comparative advantage in labour intensive sectors. MNEs responded by relocating these aspects of production in the periphery. This was a 'vertical' form of integration characterized by different factor endowments and leading to unidirectional flow of Investment from countries with an abundance of capital to countries with abundant labour. As the EU periphery tended to have lower wages it was expected to benefit from this relocation. This movement was consistent with traditional theories of international trade.

New Trade Theories, by accepting the existence of imperfect competition, increasing returns to scale and product differentiation provide an alternative explanatory motive for trade and, as an extension, has different locational implications. Economies of scale, at firm or plant level, could occur through specialization and large scale production, leading into intra- industry trade (Helpman and Krugman 1985). The new economic geography models claim that these new patterns of trade, linked with changes in trade costs, could explain the agglomeration of production. "The key determinant of geographical advantage is the ease of interaction with other economic agents - consumers, suppliers and perhaps also sources of information technology. The location of these things is of course not fixed, but endogenous, as new centres of economic activity can and do develop" (Venables 1998: 4)

Regional Economic Integration, linked with the existence of economies of scale, and possibly falling transport costs, may have important implications for the location of industries. Lower labour costs in the periphery may not be sufficient to attract new industries, instead the core countries may provide higher geographical advantages. Industrial agglomerations may intensify, leading to increased divergence between core and periphery.

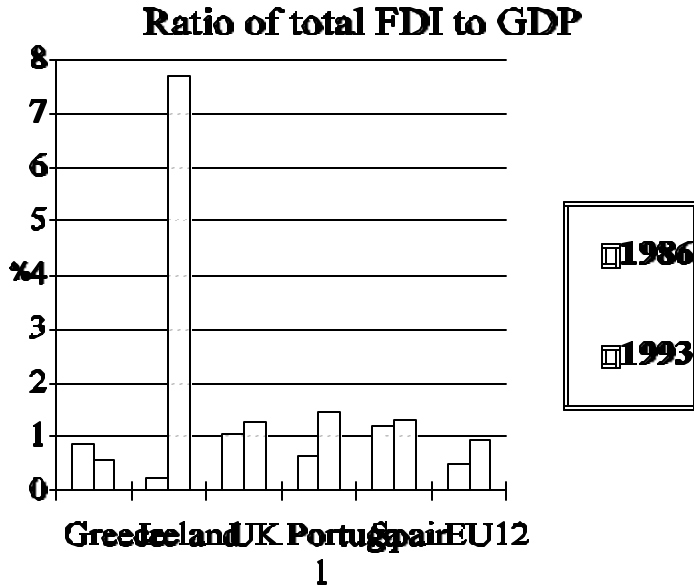
4. Foreign trade and foreign production in Ireland and Greece.

The embedment and linkages of indigenous firms in the local, as well as their sharing of common interests with the rest of the community, is in stark contrast with MNEs, whose local strategies are often determined by global interests. However, Small to Medium Enterprises (SMEs), by far the most predominant form of operation of local firms in Ireland and Greece, despite their prominent advantages, cannot play a decisive role in the developmental processes of the two peripheral economies. In 1996, SMEs with 0 - 9 employees represented 97 percent of all Greek firms and 90 percent of Irish firms (The European Observatory, 1997). Their very small size, lack of capital and/ or significant linkages with increasing returns to scale (IRS) firms in the manufacturing sector did not allow them to become levers for change.

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Recognition of these internal weaknesses persuaded Ireland to opt for an export led growth, through the attraction of MNEs, with more or less clear policy objectives and strategies. In Greece, there was a lack of both clear objectives and policy structures. Ireland, in 1969, established the Industrial Development Agency, IDA which followed a pro-active, market-led, interventionist policy. State policy evolved over time, but effectively it involved attraction of foreign capital through financial incentives, identification of areas of high growth and parallel efforts to improve educational standards and enhance the skills of the work force. Financial incentives included a very low preferential corporation tax of 10 percent, which proved very decisive in attracting MNEs into Ireland, and discretionary grants awarded on specific projects. These eventually led to the creation of clusters of industrial production. The parallel efforts to raise educational standards paid a dividend and by 1996 Ireland had the second most skilled, but relatively cheap, labour force in the EU (OECD 1997). The efforts to move into high value added production was assisted by the existence of this skilled labour force and by high R&D spending. In 1987 - 1993, Ireland, with a R&D to output ratio of 2.30 (Greece 0.67) was ahead not only of all other EU peripheral countries (0.93), but even the EU12 average of 1.55 (European Commission 1996)

Graph 2:



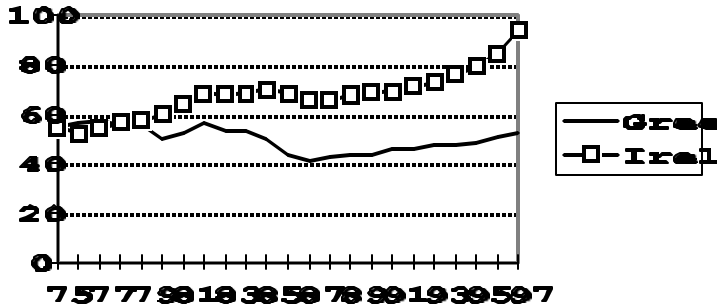
Source: Eurostat

FDIs attracted into Ireland were quantitatively and qualitatively of a different nature than the ones normally attracted in the periphery. They amounted to almost 8000m ECU in 1993 representing 6 percent of all inflows of FDI into EU and 8 percent of GDP while the equivalent value for Greece was only 1000m ECU, 0.8 percent and 1 percent respectively (Graph 2). They were further in high tech, capital intensive industrial sectors such as computers, chemicals etc.

Although overall capital intensity remained low in Ireland throughout this period, this was compensated for by high levels of productivity of capital, the highest in the EU and one of the highest in OECD. Total factor productivity (TFP) growth representing the contribution of technological progress and calculated as the residual, after allowing for labour and capital productivity, was almost 5 percent in Ireland in 1995 but 1.5 percent in OECD (OECD 1997). This high TFP growth is the result of the operation of MNEs in the Irish economy. The indigenous capital is characterized by lower TFP, as it is concentrated in small, labour intensive units. The effect of the attraction of selected MNEs and higher levels of productivity was the resulting convergence in GDP per capita between Ireland and the EU15 in sharp contrast to Greece.

Graph 3:

Per Capita GDP. EU 15 = 100



Source: Eurostat, 1998

Ireland is primarily used as a production platform for export purposes. This is not surprising given the size of the Irish economy. In 1993, MNEs in Ireland, produced 68 percent of total manufacturing output, employed 45 percent of the workforce and exported 88 percent of output. This is even more intense in sectors such as Chemicals (94 percent of output, 96 percent exported) and Electronics (92 percent and 88 percent respectively), (Ruane and Georg, 1997). The outcome of the operation of MNEs in Ireland is thus the creation of a dual economy. The foreign sector is strong, capital intensive, export oriented contributing to fast growth of GDP; in contrast the domestic one is weak, and inward looking

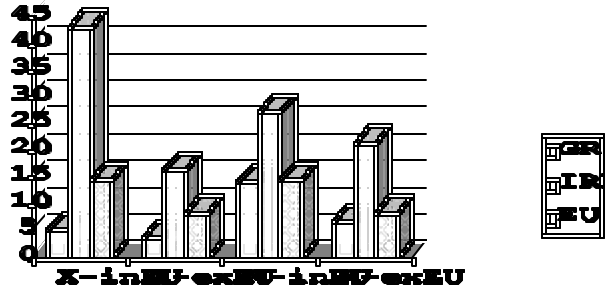
The indigenous manufacturing sector experiences considerable difficulty in achieving a firm foothold in international markets. The dualism is to be found in these differences in market operation and market power, technology, management structure and plant and firm scale. Most important of all, the term dualism refers to the weak linkages between the foreign-owned branch plants and the Irish economy. (O'Donnell 1993).

An indication of weak linkages with the domestic economy is the very high content of imported inputs in MNE production. Non-labour inputs from domestic industry represented 22 percent in the chemical industry, and 23 percent in electrical goods; in contrast, the average domestic inputs for the economy as a whole is 77 percent (European Commission 1997).

The high orientation of MNEs to foreign markets had a strong impact on the Irish balance of payments. The latter is characterized by high levels of export and imports, as a result of high dependence on foreign resourcing for MNEs production, as well as high levels of capital movements as a result of profit repatriation which amounts to 10 percent of Irish GDP.

Graph 4:

Intra and Extra EU Imports



Source: Eurostat

Further, as a result of the concentration of production in capital intensive sectors, MNE induced high rates of growth have not fully resolved the problem of unemployment. However, the latter fell dramatically from its highest levels in the early 1990s and is now only slightly higher than the EU average. This is in sharp contrast to the other peripheral countries such as Greece and Portugal, whose concentration of production in labour intensive sectors kept unemployment relative low but rising.

The very limited activity of MNEs in Greece was the result of a combination of internal and external factors. Greece is geographically the most peripheral country in the EU; the only one without any common frontiers with the rest of the EU. This geographical peripherality together with adverse political events in neighboring Yugoslavia added extra transport costs and created a climate of instability.

These factors were further exacerbated by adverse institutional structures. A slow and antiquated administration, a state based on favoritism, populist policies directed to satisfy particular interests and the lack of any clear policy directions had a negative effect. The 1980s was a period of lost opportunities. The foreign capital left Greece and the national capital failed to modernize. The effects on growth and employment were dire.

5. Policy for growth.

The experience of the peripheral countries and particularly Ireland shows that MNEs could generate both growth and convergence. Ireland was very successful in using intelligently the Funds from the EU and for generating an institutional framework within which high tech MNEs were attracted. This raises the issue as to what general conclusions could be drawn. Two important questions arise in this case.

Can small countries, at an intermediate level of development, depend on their indigenous capital to realize growth and achieve convergence? Secondly, in a world dominated by the global movement of capital and the internationalization of production how relevant is the issues of ownership; i.e. does the nationality of a company matter? In the first case, the experience from Ireland points towards a negative answer. Domestic capital cannot create the preconditions for 'catching-up'. In most cases it possesses limited resources, lacks R&D, know-how and managerial skills, it is inwardly looking and in cases unwilling to invest internally. Further, years of cushy relationships with governments and political parties have deprived them for the desire for change. In this sense the inflow of foreign capital could have a cathartic effect. It could force changes in production and management and instill institutional and administrative changes. Thus, to the extent that MNEs are used successfully as a lever for the development of the domestic physical and human capital and the introduction of modern technology, they could facilitate the process of development. In the last years, all countries which have experienced impressive strides in their developmental process have all succeed through the intermediation of foreign capital. Nonetheless, there are serious drawbacks, as the experience from Greece in the 1970s showed. Lack of proper linkages with the domestic economy left the economy unable to assume the role played by foreign capital although the latter decided to leave the country.

In the case of Ireland the movement from a very protected economy to a very open one, attracting MNEs and achieving an export led growth, brought unprecedented growth but created its own problems. Ireland became too dependent on foreign, and in particular on US, capital. Foreign companies control almost half the employment in the manufacturing sector and half of it is USA controlled. Domestic companies failed to benefit from this influx of foreign capital as backward and forward linkages were rather low. Further, while MNEs enjoyed impressive financial incentives, the same assistance was not available to endogenous firms. An EU enlargement and a possible relocation of some of these companies to other EU regions could have fundamental repercussions for Ireland, while crises in remote parts of the world could have immediate effects on it. On the second question, 'ownership' by itself may not be the overriding issue, what

matters is economic control. MNEs as a result of their vast resources, their international outlook and their ability to move capital around the world, could undermine national economic policies and threaten national sovereignty. Further, the openness associated with the operation of MNEs does throw a country in the midst of an uncertain, more unstable world, with little national control over its own path of development. Possibilities of protecting from global shocks are more difficult and the problem of 'contagion' more clear.

Clearly, policy decisions are very difficult. As indigenous capital cannot, on its own, play a commanding role within the new globalised environment the role of MNEs is becoming necessarily more central. The selective assistance of indigenous firms and the creation of clusters around areas of national competitive advantage (along the lines of the Culliton Report, in Ireland) and the linkages between those firms and the MNEs may be the way forward.

6. Conclusions

The aim of this paper was to examine the role of MNEs in the developmental process of a country. It drew on the experience of two EU countries which were at very similar levels of development and with similar structures in the mid 1970s, but experienced divergence since that time.

Within the EU, Ireland is the most prominent case of convergence. Its export-led growth policy paid a dividend. It was based on the attraction of MNEs through financial and other incentives, and on the improvement in human capital, by extending education and financing R&D. The result of this policy was an unprecedented increase in growth rates and a restructuring of its economy from a backward agricultural to an advanced high tech economy.

Greece, on the other hand did not manage to make the breakthrough. It is still entangled in a web of internal and external problems. Its failure to attract MNEs and the parallel inability of the indigenous capital to generate the capital accumulation necessary for growth led to its very poor economic performance.

MNEs nonetheless do not offer instantaneous solutions to the problems of slow economic growth and development. Their own presence and role is problematic. Their economic and political power could undermine national economic policies, threaten national sovereignty and expose a country to instability and 'contagion'. The relationship between MNEs and indigenous capital is also problematic. The local industry in both countries has remained weak and it is questionable whether it could play a leading role in the developmental process. It is true that in the case of Ireland, financial incentives to the MNEs deprived local firms of funds, but even if these funds were directed to indigenous companies, it is not clear that they could have played a

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leading role. Their size, and managerial skills together with serious structural weaknesses were prohibitive factors.

The most important problems nonetheless of low linkages between local and foreign companies remain. The resourcing of non-labour inputs through imports provides little scope for local industries, while this lack of linkages did not allow domestic companies to participate in the export boom.

The assistance of strong companies and the creation of clusters of national firms which are dynamic and competitive and the creation of linkages between them and the MNEs may be the way forward.

But most importantly convergence necessitates deep structural and political changes. It necessitates the modernization of the state and state apparatus and of the institutions which perpetuate lag in the development. Often, these changes prove more difficult to achieve.

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