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The impact of the global factory on economic development

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ABSTRACT

The global factory is a structure through which multinational enterprises integrate their global strategies through a combination of innovation, distribution and production of both goods and services. The global factory is analysed within a Coasean framework with particular attention to ownership and location policies using methods that illustrate its power in the global system. Developing countries are constrained by the existence and power of global factories. Firms in developing countries are frequently constrained to be suppliers of labour intensive manufacturing or services into the global factory system. Breaking into this system is difficult for emerging countries. It requires either a strategy of upgrading or the establishment of new global factories under the control of focal firms from emerging countries. The implementation of these strategies is formidably difficult.

This paper advances four propositions.

1. A complex of causal factors under the umbrella term of globalisation have caused an international configuration of economic activities labelled 'the global factory' that dominates large areas of the world economy.
2. The existence of global factory system constrains the development options of a large number of developing countries.
3. Difficulties of mobilising entrepreneurial abilities in many countries react with these constraints to produce a difficult environment for economic development.
4. The paths to economic development under this system are:

(a) Incrementally upgrading activities within existing global factories.

or

(b) Develop global factories under local control.

All of these development options are immensely difficult to implement. This paper suggests that although there has been a radical shift in the *location* of activities within the global economy, the *control* or orchestration of these activities remains very firmly within the metropolitan (advanced) countries.

Proposition 1. *Globalisation pressures have reconfigured the world economy and created "global factories."*

"Globalisation is essentially a process driven by economic forces. Its immediate causes are: the spatial reorganisation of production, international trade and the integration of financial markets." It is not therefore uniform across economic space – "the segmentation of the manufacturing process into multiple partial operations which combined with the development of cheap transportation and communication networks, has brought the increasing division of production into separate stages carried out in different locations." (Sideri, 1997, p. 38). The strategies of multinational firms are therefore crucial to the causes and consequences of globalisation.

We can examine globalisation as a conflict between markets and management (government policies). Fig. 1 identifies three levels of markets – financial markets, markets in goods and services and labour markets. Each of these is moving at a different speed towards global integration. Financial markets are already very closely integrated internationally. No individual 'national capital markets' can have a sustainable independent existence.

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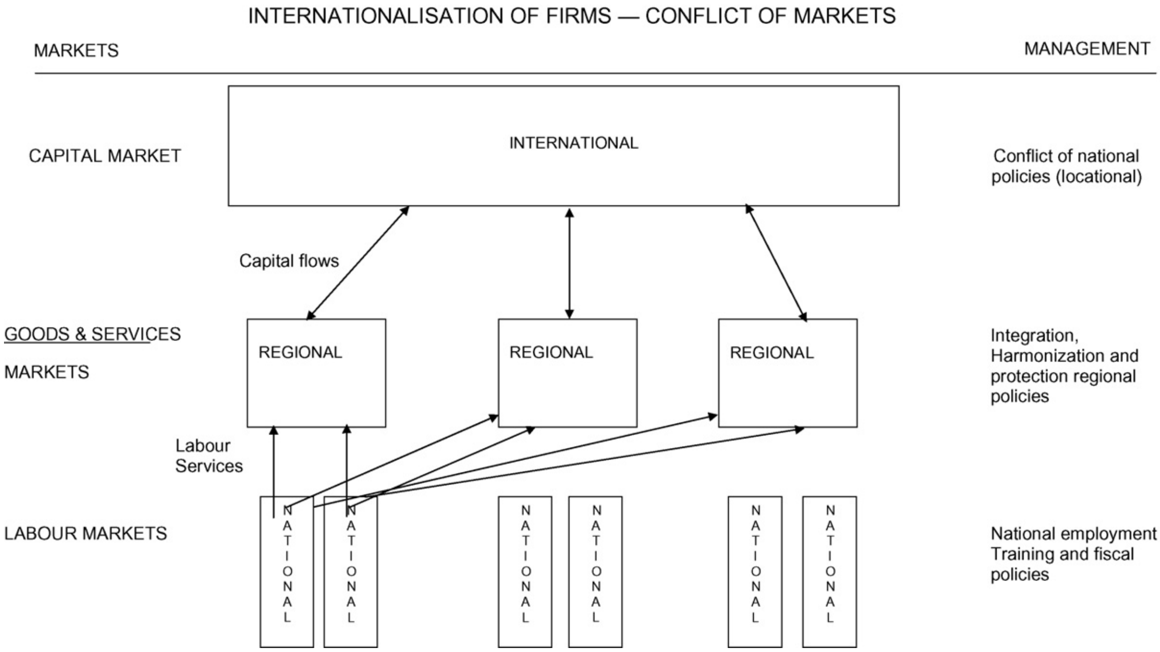

Fig. 1. Internationalisation of firms – conflict of markets.

However, attempts at national regulation do persist (Laulajainen, 2000) and the role of localities in the financial markets still provides differentiation (Berg & Guisinger, 2001; Tickell, 2000). Despite this, it is legitimate for analytical purposes to hypothesise a single integrated global capital market. Regional economic integration is becoming increasingly effective in integrating goods and services markets at the regional level. The relationship between company strategy and policy making within regional blocs, such as the European Union (EU), is a fascinating area for the development of new research streams (Chapman, 1999; Raines & Wishlade, 1999, see also Wood, 2003 on the Industrial Midwest of America). Labour markets, however, are functionally separate at the national level and here integration is largely resisted by national governments (Buckley et al., 2001).

The largest multinational enterprises are already perfectly placed to exploit these differences in the international integration of markets (Buckley, 1996). However, regional economic integration offers both large and small firms the opportunity to enjoy the advantages of a large 'home' market, whether it is their native home or their adoptive home. The operation of international capital markets (which allow firms to drive their capital costs down to a minimum) has largely transcended policy on regional integration, although each region would hope to retain its own regional financial centre. It is primarily in the arena of the creation and fostering of regional goods and services markets that enable firms to exploit economies of scale across several countries. Regional economic integration offers the most substantial size-of-country benefits. However, regional integration that encompasses countries with differential labour markets is becoming increasingly beneficial. This regional integration enables costs to be reduced by locating the labour intensive stages of production in the cheaper labour economies within the integrated area. Firms that serve just one regional market, as well as those that serve several of the regional goods and services markets of the world through horizontally integrated foreign direct investment (FDI), are able to complement this with vertically integrated FDI in quality-differentiated labour markets. Vertical integration also reflects the spatial distribution of supplies of key inputs and raw materials. The multinational enterprise achieves advantages through both vertical and horizontal integration. Each strategy is promoted by the 'size-of-country benefits' of regional economic integration in goods and services markets, which reduce or eliminate artificial barriers to trade between the members. This maximises the ability of firms to exploit intra-regional differences in factor abundance, including differentiated human capital.

On an industry level, globalisation can be shown to have an increasing impact. Gersbach (2002) defines globalisation at the micro level as "the exposure of a productivity follower industry in one country to the productivity leader in another country" (p. 209). The transmission mechanisms of change across country borders are trade and FDI. Gersbach found a strong relationship between globalisation and productivity differences with the most efficient producers. He concludes that globalisation matters and that its influence spreads beyond a single region (e.g., Europe, North America).

More attention has been paid to vertical relationships (the supply chain or value chain). The differentiation of labour markets is most acute between advanced and less developed countries which are typically not part of the same regional bloc. The managers of multinational enterprises (MNEs) are increasingly able to segment their activities and to seek the optimal location for increasingly