HOW MUCH TRADE AND FDI THEORIES HELP IN ANALYZING COMPETITIVENESS-RELATED ISSUES?[1]

by László Csaba[2]

ABSTRACT: This paper surveys the literature on the importance of geography and foreign direct investment/FDI against old and new development and mainstream theories. It finds that both play a significant and favorable role, although through different mechanisms than postulated earlier. The importance of the quality of the institutional framework, as well as conditions for human capital accumulation are added to previous insights on the crucial role of opennness and property rights. It aims at contributing to the bridge-building between modern economic theory and rather empiricist, business management oriented studies on FDI and trade.

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Ever since the famous quibble of Paul Krugman/1997/ competitiveness is seen as a „dangerous obsession". As so frequently is the case, a per se worthy statement, torn out of its original context, leads a life of its own and produces outcomes totally out of line with the original claim. The latter, in Krugman's case, has been the insight, that international trade is by no means a zero sum game, thus the gain of one does not necessarily equals to the loss of the other. While at the level of economic theory this is nothing more and nothing less than a rehash of the original Ricardian theory of comparative advantage – one of the fundamental and popularly least understood inventions in economics – at the level of policy-making the call is anything but trivial. The exclamation was triggered by legitimate concerns about growing protectionism in the US, at that time, has been levelled against relocating labor intensive industries to Mexico, and a decade later, against outsourcing of services to India and other low cost countries. In the EU, the spread of 'economic patriotism' in France, germany, Spain and Poland all indicate the continued policy relevance of this insight.

But is competitiveness indeed just a buzzword for ignorant politicians? At the level of economic theory nations do not exist, only localities, firms and the global interchange. Therefore existence of the national economy is an artefact at best, bringing about distortions only in the smooth process leading to general

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[2] Professor of Economics and European Studies, Central European University and Chair, Committee on Economics, The Hungarian Academy of Sciences. for comments: csabal@ceu.hu

equilibrium, at least for the microeconomically founded modern macroeconomics. For this reason mainstream economic theory does not find a place for competitiveness on other than the firm level. And even on this level the usual concern is unit labor cost, and existence or lack of distortionary governmental practices, such as taxation, licensing, arbitrary customs duties and other factors, rendering directly unproductive activities, such as rent-seeking profitable/Bhagwati,1998/.

Institutions Matter - But Which Ones and How?

This approach is, though legitimate at the level of the first approximation, as well as a way of ordering thoughts, is increasingly simplifying when confronted with present day realities and the experience of emerging markets. For one, locational competition has become a decisive paradigm/Siebert,2006/ in explaining changes in the pattern of production and trade. Locational competition includes a much broader aspect than direct costs and benefits, distorted/modified by wedges brought about by governmental policies and redistributory concerns. It involves the ever broader and more complex web of institutional arrangements, formal and informal alike. The quality of institutional structure, avaliability or lack of a honest, non-corruptible government, the provision of public services, as well as the level of trust all count among the contemporary components of what the World Bank terms good governance/Wolfensohn and Bourgignon,2004/. In this broader context it is no longer true that only corporations compete, and macropolicies matter only to the extent they create a non-distortionary environment for the general equilibrium to be attained via spontaneous adjustment processes of the market agents.

It has long been observed by representatives of the economic mainstream/Lucas,1990/ that real world processes do not mirror the once dominant Heckscher-Ohlin view of international trade, having explained international exchanges on the base of factor endowments. Therefore contrary to the expectations raised by this view, capital typically has not been flowing from rich to poor countries over the past several decades. Rather, physical and financial capital flows alike tended to be concentrated in advanced economies. The explanation, in view of Lucas, has been found in the policies of the poor countries, that tended to be hostile to foreign penetration, not only in terms of ownership, but also in terms of commodity flows as well as flow of personnel.

This explanation was, indeed, quite relevant at the time when import substitution, state-led industrialization and generally economic nationalism dominated the global arena. With the collapse of the Soviet Union, as well as owing to the gradual conversion of one time adherents to inward looking policies of various sorts to the new orthodoxy of outward orientation, this explanation has lost some of its weight. All the more so, since outward orientation has not been a unidimensional step changing just the assessment and workings of trade regimes. Rather it has been complemented by broader systemic policies that promoted market-oriented reforms of various sorts across the board, in most if not all of the major economic sectors. Since these polices have proven to be quite efficient in a number of ways, including also poverty reduction according to the broad survey of surveys by Winters et al/2oo4/, the appeal of various seclusive and nonmarket stategies has been pushed to the margins of the economics profession as well as of mainstream policymaking, also in most of poor countries. The conspicuous advances of first and second round of newly industrializing nations, with the latter including North Africa and Botswana in the post-199o period, have supported this line of thinking in a decisive manner. Leaving alone the ever vocal anti-globalization movements, which are, alas, typical western middle class protest phenomena, the new orthodoxy does enjoy sizable support among major policy-makers and international institutions.

Despite of these impressive developments, that might have changed not only the pattern of thinking, but also of the actual trends of trade and financial flows, a similar reorientation of the latter could not be observed. Despite opening up of capital markets/Caprio-Honohan-Stiglitz, eds,2002/in developing countries, capital flows contnue to be concentrated in the advanced economies. Likewise despite opening up the poor countries and discontinuation of statist policies in most of these, FDI also continues to be focused on advanced economies. In other words, institutional quality as well as the regulatory environment still does make a difference.

It is not least intriguing to observe that the new wave of capital market libralization has not brought about the ablition of the so-called home bias, a phenomenon that has long ben perplexing the students of international economics. In short, capital investors, contrary to widespread conceptions, do not actually roam around the global market place. Instead the typical investor invests at home, with savings and investments movements correlated over 90 per cent of the cases as empirically demonstrated by the famous paper of Horioka and Feldstein/1980/. While newer analyses/Blanchard and Giavazzi,2002/ indicate much lower numbers, i.e about o.4 for the OECD area, the basic insight is likely to remain valkid, for a number of reasons. First, if the balance of capital inflows and capital outflows is close to balance, as has been the case in the euro area ever since 1999/ECB: Statistics Pocket Book, April,2006/, the decisive role of domestic savings, at the end of the day, remains. Second and more importantly from our angle, if FDI is also about close to balance, due to the growing role of outward foreign investment already at the medium level of development, this is also unlikely to effect the domestic saving- domestic investment equilibrium in the long run. certainly, it is not our contention that the same amount/form/liquidity structure/technological and managerial pattern would be present, as in a closed economy model. However for the macroeconomic perspective it is the balance of this in- and outflows that matter. And these indicate, that with the well known exceptions of Japan and the USA, the identity seems to hold.[3]This means that growth continues to be determined by domestic factors such as savings, innovation and the efficiency of domestic capital market allocation, and other factors, including the international markets remain subordinate. This means inter alia, that the much discussed issue of tax competition can by no means be taken as decisive or macroeconomically important, since whatever this does, it could not fundamentally change the flow of investments, that continue to be financed, in their lion1s share, from domestic savings.

This might explain why the quality of domestic financial and legal system may be much more relevant, against competing considerations, than it is currently fashionable to appreciate. Financial intermediation tended to be de-emphasized during the dominance of Keynes inspired macroeconomic polices, where the per se valid claim that savings and investments are accounting identities overshadowed the complexities between intended and unintended saving, as well as the importance and implications of the difference it makes if it is households, the state or the corporate sector that saves, further if the identity holds ex ante or only ex post, through a number of forced savings and inefficient arrangements/Erdős,2003/. Likewise the importance of contracts and enforcing mechanisms via court systems/Shleifer et al,2003/ have become growingly important in understanding the process of development. These insights have formed fundamentally economic thinking. While in the traditional Samuelson type of neoclassical growth accounting technological change accountd for about 25 per cent of/productivity and thus overall/ growth, and the rest should have ben attributed to other, usually unspecified factors, the inclusion of the above mentioned two factors have fundamentally changed the overall picture. As the seminal paper of Hibbs/2001/ demonstrated, the inclusion of those factors usually watched by rating agencies, such as rule of law, enforcement of private property rights, freedom of contract and inflation together explain, in a neoclassical growth function, about 80 per cent of growth performance of countries in the long run. Likewise Heitger/2004/ has proven via regression analyses the dominant role of private property rights ower long run historical performence of countries.

[3] It is known that Japan, due to its mercantilist trade régime and domestic lull has long run a structural surplus. By contrast, the US has been compelled by Bretton Woods to run a deficit. In the post-1971 period US governments were only too keen to utilize much of global savings for financing their twin deficits, relying on the dominant role of the greenback in global finance, as well as on the depth and the width of the US capital markets, a safe haven for most surplus countries with little similar institutions, or even lack of safe private property rights/from the oil monarchies to Russia and China/.

Theories of Competitiveness and their Implications

The idea of competitiveness is not therefore derived from, or congruous with, dominant mainstream theories. Rather as the exhaustive survey of Török-Borsi-Telcs/2006,pp14-15/ rightly emphasizes, the idea originates from, and reflects the concerns of, management sciences, where the microeconomic approach is by and large given. It is hardly by chance that the founding father of competitiveness idea, Michael Porter/1990/, re-baptized the traditional comparative advantage idea into *competitive advantage* – a concept later developed in several influential publications of the fora of global business management, such as the World Economic Forum in Geneva, the IMD School of Management in Lausanne, and unsurprisingly the left-leaning labor unions oriented UN specialized organization, UNCTAD. The latter, by way of using and establishing a dominant discourse, have fundamentally shaped public perceptions way beyond the business community. Political actors and the median voter do care, and increasingly so about the relative position of the well-being of the given country, not only its absolute advances made over preceding periods. Likewise the fear of lagging behind, or of the consequences of ever more localities` and previously poor countries' inclusion in the global economic intercourse, has already created fears and hopes, inter alia about the demise of the nation state and of the loss of once attained social rights and public provision of welfare.

Even leaving aside the latter fears for discussions on globalization, it has become imminent that the content of the concept has undergone a basic change. First: comparative advantage, originally a cost-based supply-side measure has become much broader by involving demand side and other, institutional components and macrovariables/Neary,2003/. Second, research on competitiveness has moved away from the traditional measures of specialization, revealed comparative advantage and export pattern analyses. Instead, quite in line with endogenous growth theory, it has shifted its focus on research and development as well as on broad measures of the business environment, such as the role of education, law enforcement, the level of public services, or the quality of human capital including such non-traditional items as the cooperative or class-strugglish approach of labor to industrial relations.

The more theoretical analyses have been broadened over and above the analyses of absolute and relative market shares, trade opennness, the qualities of the trade regime or the share of IT-intensive or generally high tech products in total exports/an incessant industry for many purposes/, the more the above described macro-apprach tended to penetrate what used to be a micro-approach. The recent extensive survey of the literature by the authoritative Hungarian research group headed by Tamás Szentes/2005,pp231-362/ includes such areas as trade policy, exchange rate policy, fiscal policy, social policy and even the role of NGOs and civil society. In other words, all public activities aimed at - or invoked with reference to – market imperfections are included. And as a result dimensions of competitiveness extend to such fields as the role of multinational corporations in the economy, the type of activities relocated by the multinationals to the host country, the evolution of dynamic sectors in the economy as well as the ability of the host country to draw regularly and advantageously on external resources, financial, technological and organizational alike.

In sum, competitiveness is a term akin to 'fitness' or 'adaptive value' widely in use in biology and the life sciences. Despite its weak theoretical anchoring it is able to reflect the Schumpeterian vision of economic development. It aims at assessing performance, actual against the potential. This is particularly true of the IMD and WEF indices. Competitiveness in the latter view reflects attactiveness to foreign investors, a concept measurable only in hindsight. By the same token it is also a forward- looking concept, representing expectations on, and revealed preferences of, future development. In the latter capacity, it is a factor of evaluating future growth potential, as formulated in the more conventional theories.

In a way a quite interesting development, in line with overall trends in economic theory, could be observed. While macrotheories acquired microfounations, microdevelopments are increasingly interpeted through the lenses of macroeconomically informed theories. This interaction enables policymakers also in emerging economies to make better informed decisions than abstract trade theories or much tooo business-oriented thus down-to-earth management-based FDI theories would have allowed for in earlier times.

Early trade theories tended to focus too much on factor endowments, an approach that clearly reflected the conditions of the colonial period, but greatly misleading during the period of delocalization, dematerialization and generally at times when value creation is increasingly detached from the process of phyisical inputs and growingly depends on intellectual inputs. The reason why R+D outlays and structures have been revalued lays precisely in this consideration. As long as growth theory no longer rests on factor accumulation and related models/Easterly and Levine,2001/, likewise trade theories no longer are based on resource abundance. On the contrary! Experiences with resource abundance over the post-1973 period have invariably called for the grave dangers inherent in a resource abundant economy, especially, though by no means exclusively, at a higher level of development.

The first such experience was that of the Netherlands, where the exploration of rich natural gas fields has lead to structural ossification, as the government was allowed to pay for the continued existence of such activities and sectors, whose revenue earning capacity had already been seriously diminished by the changed world market price relatives. As long as Holland could pay for the undifferentiated maintanance of jobs and their security, Holland has delayed her structural adjustment by a decade, and the measures correcting these have proven much milder and less eficient. This has been baptized in the literature as the Dutch Disease.

It is interesting to note that the old debate of the Dutch disease, i.e if and to what degree resourse abundance is a curse, has been recently revived in the debate over Russian economic growth. It is demonstrable/Mau,2005/ that Russian economic recovery of the post-1998 period have been driven by such factors as currency devaluation and reliance on primary exports. This circumstance has triggered a broad debate if and for how long this path of growth is sustainable. Side by side with the traditional doubters the proposition has ben voiced/Köves,2005/ that the theory of comparative advantage would rather caution against attempts drawn from abstract theory „to save Russia from its oil wealth". While the reference to the need to specialize along the lines of comparative advantage is well taken, the conclusion suggesting that there is no need to worry about Russia's unilateral export pattern seems to neglect the bad experience of other countries summed up under the concept of Dutch Disease. Delaying adjustment may, inter alia, bring about ossification and increase the costs of a later day adjustment that will be inevitably triggered by markets, unless the everlasting growth of prices for primary commodities *in toto* is being postulated, contrary to historical experience and economic theory in general.[4] From among the latter consideration let us refer to such century-old insights as Engel's Law based on the different demand elasticity of final and intermediate products, or the secular diminishing of primary inputs in the overall wealth creation that is due to the nature of technologial progress in the post-1973 period and has been accelerated by the spread of information technology in the traditional sectors.

Perhaps and even worse misdevelopment is what the political economy literature on developing countries has termed the resource curse/Ross,1999/. The resource curse is worse insofar as economic stagnation similar to the Dutch disease of advanced countries may be complemented by a reliance on authoritarian methods of control, both in th economy and in the political system. The crux of the argument, tested on a number of empirical cases, especially on the Middle East oil monarchies, and increasingly also on Central Asian states, is

[4] This is not to belittle the dangers inherent in the geoglogical and organizational constraints on crude oil production, that is, according to informed scientific analysis/Bárdossy and Lelkes,2005/ likely to lead to peaking of oil production in 10-15 years. But other sources of energy remain, thus the relative price of all energy, as different from gasoline, is unlikely to explode in direct proportion.

that the capital intensive and cooperation-poor nature of fuel extraction, that neither requires nor allows for the famous Hirschmanian forward and backward linkeages in terms of technology, market relations and interfirm/intersectoral intertwinings in general. Furthermore it also is supportive of the authoritarian methods insofar as the nature of the industry does not call for the Toyotist revolution, based on lean hierarchies and broad cooperation among teams and their committed members. On the contrary the rents appropriated by the despots can in part be used to buy out most of the population and cement the oppressive apparatuses. Thereby a vicious circle of one-sided specialization-authoritarian rule-rent seeking-low economic and social efficiency-low mobility-further corruption of society is being created. The above described chain reaction explains the otherwise puzzling fact that resource poor countries of east Asia have been flourishing, while resource rich countries of the Middle East have not. In a worst case scenario, theorized by Ross, the distributional conflict enhances the chances for civil war and complete state failure, as evidenced e.g in Sierra Leone or Iraq, Angola or Sudan.

The more we are aware of the dangers of resource-dependent development the more we are likely to care about the pattern of exports. The latter is not to be measured by artificial indices of various sorts, or on abstract considerations, but primarily through the ability of foreign sales to earn sufficient amounts of currency needed to cover needs of modernization of consumption and production, investment and services. As empirical evidence has long been indicative of the superiority of export patterns dominated by high tech and engineering products, observance of the improvement of export patterns of countries remains relevant. Buth with the transition to the services economy, dominated by th tertiary sector, the share of services, especially of financial services is likely to increase. This also means that the process of localization – the counterpart of globalization – is likely to revert and diminish the trend of ever opening of national economies in quantitative terms.

The Spatial Dimension

Economics, especially in its mainstream version, tended to crowd out such traditional factors of economic development as history and geography. In the growth regressions overall growth performance is being analyzed. Likewise in formal trade theory nations or corporations are being modelled and their gains and losses assessed in an aggregate fashion. This is in sharp contrast to traditional political economy approaches where redistributory concerns among sectors, classes and nations used to figure high on the agenda.

It is common knowledge that the emergence of increasing returns, economies of scope have fundamentally changed the assumptions of traditional economics where diminishing returns were axiomatic. Also experience, not only in developing, but also in developed counttries has called attention to the importance of spatial concentration of economic activities and called for public policy intervention remedying the consequences of these.

From these casual observation an entire strand of literature has emerged under the heading of New Economic Geography/Ottaviano and Puga,1998/. This line of analysis has been quite influential in providing new insights and more plausible explanations to frequent developments that seem to have fallen outside the scope of explanation provided by the dominant trade theories. This line of thought has proven the relevance of the spatial factors, byt pinpointing to a number of cases where location rather than other factors is demonstrably responsible for most of the outcomes. At one level, where closeness to major growth poles is shown to matter, sounds anything but counterintuitive, the more we think about the importance of forward and backward linkeages and of the importance of physical and human infrastructure, stressed by more conventional economic theories of development.

However the new economic geography literature has gone much further than that. For instance, the home bias phenomenon in international trade, diametrically opposed to the very idea of general equilibrium/GE and Computable GE models, dominating trade analyses, has proven to be persistent rather than diminishing with the passage of time/ Head-Major-Ries,2000/. This runs counter to such widespread claims- rather than 'theories'- such as the global tax competition, the unbrindled unleashing of forces of globalization, allegedly having taken unprecedented scales, or that trade opennness should be secular while localization temporary. While the latter suggestions dominate a considrable part of international relations and political science literature, these do not take account of the opposite facts demonstrated empirically.

Likewise growth is normally related to technological progress and innovation, that are finally domestic factors. If for no other reason, because of the limited and temporary role played by FDI, it is domestic savings, domstic financial intermediation, and domestic investment among the factors determining the long run rate of economic growth/Erdős,2006/. As the latter factors can only indirectly and uncertainly influenced by governmental policies, the long term growth potential is not influenced by these. Moreover the international factors, such as foreign direct investment, allow only for a temporary increase in growth rate, as with the passage of time its contribution to technological progress is bound to diminish/due to the nature of arithmetics/. Furthermore direct inward investment is, if it is strategic, gradually followed up by outward direct investment, a process turning the capital balance close to zero already at medium level of development.

While this is the standard and solid reasoning, new economic geography has found a strong correlation between agglomeration effects and endogenous capital formation/Baldwin,1999/. Through this backdoor the spatial dimension re-enters to the formalized approaches.

An even more intriguing insight comes from the seminal paper of Krugman and Venables/1995/. The two leading authorities of the NEG strand of theorizing come back to one of the eldest issues in international trade, that of transport costs. They show the changing influence of transport costs for monopolistic markets when globalization is also taking place. While under such circumstances high transport costs may lead to the spontaneous emergence of core-periphery relations, s postulated by the old dependency school, with the decrease of transport costs the situation may indeed be reversed. Less developed countries stand to gain more and more developed nations less from such intercourse. The morale of this intellectual experiment is straightforward. As long as the IT revolution renders distance greatly irrelevant for a large number of economic activities, thus making global sourcing and global market strategies a rule from the exception, the chances of less advanced nations for being able to profit from more involvement in international exchanges is likely to increase. This finding is basically supportive of earlier insights/Balassa,1993/ on the advantages of outward oientation, broadly understood, i.e encompassing not just the trade régime, but the entirty of economic system in a market-conforming manner.

New economic geography hs brought about interesting insights in the analyses of transition economies as well. While the mainstream theories of transition tried to attribute the success or failure of individual countries to institutional or policy factors in its entirety, the spatial dimension has indicated some interesting modifications. For instance Slovakia`s economic performance, as measured by market shares, expor tpatterns and dynamics, has already beeen remarkable in the Meciar period, that is in the years having *preceeded the radical reformist policy of the Dzurinda governments.* In explaining the outcomes Soós/2ooo/ has proven the decisive importance of Slovakian location. Being situated quite close to the growth pole of central Europe, which is the Munich-Milan axis, the country has outperformed not only most of its competitors, but the levels theoretical models suggested for it to take, under the usual ceteris paribus assumptions.

Finally mention should be made of the recent analyses having stressed the continued and secular importance of the geographic factor in shaping trade and even investment flows. This finding is counterintuitive and runs counter to the naive expectation based on introductory microeconomic insights, that would expect financial liberalization and globalization to eliminate such factor while approaching the global general equilibrium. In reality, as the analysis of Guerlin/2006/ has proven, geography remains relevant even after controlling for macroeconomic fundamentals. This is one explanation why the dominant North-North FDI flow is basically horizontal, while the North-South flow is vertical. In his interpretation geography can be taken as a proxy for information costs – a finding that is in line with the previously quoted Krugman and Venables insight.

Foreign Direct Invstment - a Curse or Blessing?

It might be legitimate to recall that the role of FDI has always been seen in a broader context. As long as development economics tended to be a revolutionry sub-branch of economics, deliberately defying considerations of the manstream/Walbroek,1998, Szentes, 2002/its economic logic tended to be largely reactive. Reactive to the experiences of the colonial period characterized by free trade, currency convertibility and full capital mobility. The ensuig traditional developmental paradigm was thus inward looking, statist, hostile to FDI and capital account openness in general. In a way this has been a coherent, though by no means efficient, worldview that had laid the foundation of policies for most of the 1950-1990 period.

It is hardy by chance that the gradual emergence of the new developmental paradigm, based on open markets and export orientation, less state activism in picking winners and a more friendly attitude towards private property has triggered a change in the assessment of the role of foreign investors. The new paradigm has become friendly to foreign investment and appreciative of its multiple benefits, static and dynamic. In short, foreigners are able to introduce precisely those elements of the business environment that used to be missing under the conditions of seclusion. These include management skillls, relational capital, know how, technology, market access, continuous upgrading of physical and human capital as well as spillovers of various sorts to all those parts that relate, one way or another, to the external sector, which is often dominant in most of the poor countries.

It is hardly by chance therefore, that those marginal views, that continue to adopt an openly hostile and merely ideological approach towards foreign investment consider the pro-FDI approach in terms of return of intellectual colonialism and a discourse aimed at restoring colonial dependencies/Biccum,A,2005/. It must be noted, however, that such views have become truly marginal by now, in terms of intellectual influence and policy impact alike.

The critical mainstream has adopted a more sophisticated approach. Those who disagree with the emerging new development paradigm, emphasizing the focal and lasting role of FDI in the continuous upgrading of local economies and integrating these in global processes in the broadest possible sense, adopt a differentiated view. They do accept that reliance on FDI is perhaps inevitable, at times even favorable to the host country, however they emphasize the asymmetry in dependences and the unfavorable side-effects of too much integration. As regulatory failure, also in standard economics, is indeed conducive to perverse, socially harmful outcomes of unregulated market processes, it is not surprising that such claims can mostly be substntiated by reference to empirical observations. What remains contested is, however, the overall theoretical signifiance of thee insights. Methodologically speaking it remains mostly unclear, how and on what grounds individual phenomena lend themselves to the sweeping generalizations of critiques, drawn from particular individual cases, that are always context-dependent.

One of the more powerful arguments cautioning against too much FDI is based on the Mexican experience, generalized in the theories of the ***maquiladora*** industries. These mean in translation assembly line production plants, whose output is typically exported in its bulk, mostly to distant/foreign markets, thus leaving little room for domestic linkeages of any sort. The traditional/classical criticism, as explained inter alia in Broad and Cavannagh/1991/, points to the fact that such type of development leaves little room for national industrial or structural policies, including ones that would aim at a better integration of domestic and export oriented sectors, or upgrading the domestic economy along priorities set by a sovereign state. On the other hand, it would be a fallacy to deny that Mexico has, through this way, outperformed those economies in Latin America,where no such assembly lines have been created.

In a related line of thought a re-newed emphasis on production patterns is observable. In line with the traditional structuralist approach, having dominated both old political economy and development economics, the unequal dependencies within the production chains is being emphasized/Gereffi,1997/. Once a locality is integrated as a subcontractor, its role in the value chain is likely to be cemented at a low rank. Commodity chains that emerge via global sourcing and marketing, create new subordinations.

It would be wrong to deny the potential for such a development. However it would be equally wrong to deny the major successes in terms of structural upgrading in two dozens of countries over the past thirty years. If the trend towards diferentiation along Marxian intuition would indeed hold, with the poor becoming poorer while the rich richer, all due to the logic of market mechanism, catching up could only have been marginal and transitory. This has not been the case/Kelly,2005, Crafts, 2004/, thus reflection on the partial issue should be embedded in the overall thinking about the global economy.

It is interesting to note that in his newer analyses Gereffi and associates/2oo5/ also pinpoint to the diversity of the forms of coordination and dependencies observed in the workings of the MNCs. In their categorization five major sets exist. These are: hierarchies, captive, relational, modular and market types, with linearly decreasing high level of explicit coordination. While this insight, drawn from management sciences is obviously pertinent, it does not follow that those starting up from lower layers are bound to remain there. Actually, both Hungarian and globval experience is indicative of a process of gradual maturing or graduating. In short, while in low quality-low trust environments more centralized control forms and the parashooting of persons trusted in the hub/corporate center dominate, with the passage of time and evolution of the business environment it is likely to change. Even in relatively less developed institutional infrastructures, such as the Romanian, tacit and local knowledge may be the key to success. Thus the interest in finding highly qualified or retrained locals, rather than to send bosses from the home country, is the viable strategy.

Likewise if the usual assumptions of economic theory hold, poorer countries are characterized by lower overall price levels. As productivity is mostly also lower, this does not necessarily mean a real cost advantage. However if the first basic technology-intensive investments are made and human capital is trained above the minimum level, the incentive to increase local content across the board is given. Therefore the crucial role of proper exchange rate policies, especially of real exchange rates – a finding that recieved robust empirical substantiation in the recent literature/Xing and Wang,2006/.

One broad strand of the literature continues to be finally agnostic about the developmental effects of FDI. Chowdury and Mavrotas/2006/ emphasize the mutual relationship between growth and FDI, a finding that is similar to modern growth theory's accepting that growth may require and thus cause investment, rather than the other way around, as had been postulated by the more traditional approaches/Blomström et al,1996/. In terms of FDI therefore the co-evolution rather than the causation, that would run from FDI to growth could be established.

Oher basically agnostic analysts, however, are more positive in terms of policy implications. In their finding/Hansen and Rand,2006/ if FDI causes growth, it does via knowledge transfer and the adoption of new technology. The latter may contribute to the accumulation of endogenous factors of growth. This is in line with earlier findings/Bruton,1998/ having rejected the strategy of import substitution precisely on the grounds of its impeding knowledge transfer and local innovative forces alike. While the latter obviously follows from the statist nature of the import substituting industrialization, the critique is thus more far reaching and deep going than a mere rehash of the traditional criticism of Soviet style industrialization.

In the same vein the knowledge and skill component of FDI is being reiterated in bringing about the spillovers to the rest of the host economy. In their overview Kar and Guha-Khasnobis/2006/ find trade liberalization and well targeted local policies to be the key. If trade liberalization allows for more FDI in the labor intensive local industries, it may generate technology transfers, but only if local reception capacity is being built up. In the latter case labor biased FDI is likely to contribute to the decrease of the wage gap, thus even from the social point of view the outcome is likely to improve.

In sum, the theories surveyed above call for a more sophisticated treatment of FDI, than answering the popular 'is it good or bad' question in direct would imply.The quality, type and structure of FDI are each vitally importantand so is the interction with the domestic regulatory environment.Most of the preposterous cases and scandals, often invoked by the anti-globalization literature, are textbook cases of *regulatory failure.* Also it is no novelty to find, that a predatory state, or even just an intransparent regulatory environment shortens business horizons and render capital flight into a fully rational strategy. Investment, if confined to the primarsector only, is unlikely to produce any spillovers, if for no other reason, because of the limited nature of its foreward and backward linkeages.

It is important to note that new FDI theories, complementing previous insights, are typically in line with mainstream neoclassical and endogenous growth theory. These call for observing universal laws of good governance and sound conduct of policies based on general insights and caution against too much focus on special incentive schemes that may prove too costly for too long for the majority of the taxpayers, while its benefits are limited and temporary at best. Also the latter has become more receptive to institutional insights, appreciative of contextual factors, especially when the analyses are being conducted at a lower level of abstraction, with the aim of influencing those policy outcomes, that fall normally outside the scope of mainstream analyses.

Some Policy Implications

The above presented, far from exhaustive, survey of more recent theorizing on trade and foreign investment has produced some policy relevant insights as well. First and foremost we do not see any return to the old developmental paradigm of statism and import substitution. Second approaches that return to the once dominant Marxist, structuralist and other approaches, such as sectoral political economy and dependency theory, are in a demonstrable minority, both in the intellectual and in the policy arena. While nationalism and the resultant seclusive and statist suggestions obviously reemerge in the policy discourse, they are marginal in the academe.

A third finding is that with the convergence of the more applied and more abstract lines of analyses, the policy recommendtions typically tend to converge along more standard propositions, that Walbroek/1998/ aptly termed the one world consensus. The idea that what is sound policy for OECD countries should also hold for less developed nations is no longer seriously being challenged.

The source of recieved wisdom, as we demonstrated, is by no means the output of the international financial institutions, as oftentimes alleged/assumed by the globalization and policy oriented literature. The advice of these, as could be demonstrated already at the onset of transition/Winiecki,1993/ has constantly been partial and fragmentary, both from the theory and policy perspectives. In our survey we have hardly ever relied on the output of the IFIs. If expanded, of course additional references, pointing to the fact that these also swim with the broader intellectual tide of combining mainstream and neoinstitutional insights, could well have been shown.

Fourth, also in line with the broader developmental literature, the role of FDI an openness, as a package, is being growingly appreciated. It does not mean that any FDI in any amount, at any point of time, and any form is good, for any nation. Such extreme cases as that of Azerbaijan or Gabon, when in certain years inward FDI exceded the nominal value of GDP are obviously to be seen as derailments, as fallacies of overinvestment on the colonial pattern, in extracting industries with no spillover. But the fact that a beefsteak may be burnt, does not imply, that it also must be burnt under all circumstances, even if all of us have already encountered such eventualities. In reality, emerging economies, when graduating, are likely to engage in outward FDI to an ever greater degree. With the latter their net FDI balance may come close to zero, a proces already observable even in such emerging economies as Slovenia and Hungary during the 2ooos. This precludes reliance on FDI as a counterbalance to regular trade deficits and a sizable add-on to national savings rate. Still, this development is also the best indicator of their breakthrough in their overall catching up!

It is interesting to observe that the literature of the quickest growing economies, such as China and India is basically positive on the growing role of FDI in these/Kehal, H.S,ed,2005/. Analysis of the emerging economies in general and of postcommunist experience in particular has shown the beneficial impacts of FDI/Csaba,2005/. In the quantitative plane we do not find any single case where the sufficently high rate of export growth could have been secured without reliance on FDI in the strategic sectors. Moreover, if not just growth, but broader issues of development and modernization are considered, the finding is even more pronounced. In line with the broader literature, technology transfer, skill development, competitive pressures, modernizing influence of networking and management know how and many others vouch warranty for the predominance of favorable effects.

True, as a sixth finding, host countries may need a more sophisticated policy than reliance on low unit labor costs and granting large scale generous tax rebates or tax holidays, as is customary in countries where policies are unreliable and thus the business environment is a high risk one. By contrast successful countries like Ireland or Belgium do not compete on tax grounds. The more traditional „suspects", such as good physical and human infrastructure, rule of law, observance of property rights and a low inflation/low deficit environment, generally the rule of law seem to matter much more for the success. The latter operate, by and large, via indirect and dynamic, that is microeconomic mechanisms.

Governments may want to assist the process by creating the above listed side condition, by investing into education and law enforcement, by setting the standard by observing the rules by the state organs, even if it runs contrary to short term policy or fiscal interst may be the key.

Seventh, it is important to observe that analyses of emerging economies/Keren and Ofer,2002/ has shown the importance of bank privatization during this process. If banks are not privatized they are likely to become parts of rent seeking by industrial interest, as well as to political hostage taking. In a way corrupt banks contribute to captive and inefficient states, that in turn prove unable to play their basic roles of being the impartial referee, enforcing the rules, rather than serving vested interest. If the latter is the case, tendencies for lagging behind are being reproduced inevitably- as the posthumus work of Mancur Olson/2000/ repeatedly demonstrated.

Concluding Remarks

Having surveyed a brad spectrum of theories this study has not aspired to be exhaustive. The concept of competitiveness remains without firm anchoring in any established school of economic theory, be that macro or micro. 'Composite' theories are by no means equivalent substitutes.Still, the broad Schumpeterian view of development allows us to make use of the related analyses.

In closing it is legitimate to expect a direct answer to the question raised by the title of this article. The answer maybe threefold.

a/ By studying academic trade and FDI theories – rather than analyzing discourses about both – analysts and policy-makers may gain some insights into what NOT to do. This is certainly less than a blueprint for reform, a cookbook to go by, or a master plan for describing the list of tasks to be solved and their optimal sequence. Still, thinking of the Ten Commandments, one may be tempted to appreciate simple maxims with clear, though complex, implications for different contexts of action.

b/ These theories *do converge with broader macroeconomic theories*, including the development and the policy literature. All these stress the need for sound fundamentals as a precondition to address any specific isue of development. Fiscal sustainability, transparency, rule of law/ also in taxation/, excluding the exchange rate risk/by joining currency unions/ are the ways for emerging economies to progress in terms of freedom and welfare. if these 'usual suspects' get out of hand, specific policies aimed at enhancing competitiveness, such as granting tax holidays or keeping ULC low, may eventually backfire.

c/ The third suggestion sounds: *beware of micromanagement!*The more a government gets involved in a series of measures aimed at specifically bolstering various side aspects of competitiveness, such as granting targeted subsidies to specific forms of FDI, or by contrast, attempting to squeeze foreigners for domestic populist/redistributory purposes, the higher is the likelihood of failure. The latter is rooted in the fact, that administrative and analytical capabilities of any bureaucracy are limited, while the number of practical problems is infinite. If limited dministrative capacities are wasted on special interest politics and micromanagement, the basic function of macroeconomic control is likely to remain unattended. Once public deficits, growing debts, law enforcement, provision of high quality R+D and proper education are neglected, the government may cease to be a provider of public goods, and regresses into yet another – and often predatory – interest group.

d/ Last but not at all least, as our survey of New Economic geography idicates, *distance still matters.* This applies in the more conventional terms, such as distance from the technological frontier, and also in the sptial dimension. In the former, the more backward a country is, at the starting point, the greater the potential for a temporary but accelerated catchup, provided policies and institutions are right. In the latter, being located to close to growth centers is per se a plus, while being distant, small and landlocked, surrounded by crisis areas, is a minus. This feature amay indeed overshadow other effects. Baldwin and Krugman/2oo4/ talk about an agglomeration rent, that allows for the core region to levy higher taxes and still not fear the massive outflow of capital, thus tax harminization is rarely observable in real world economies, also among OECD countries. Thus actual long term outcomes should not be fully ascribed to good or bad policies, limits to decisionmakers should therefore clearly be acknowledged.

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