Chapter 1

Competitiveness, internationalization and local development: emerging scenarios

Giancarlo Corò and Mario Volpe

Ca' Foscari University and TeDIS-Venice International University

1.1 INTRODUCTION

In the debate about development the issue of internationalization has a high rank. Other than the traditional vision of export activity pushing the domestic economy toward a virtuous circle, it is now recognized how international relationships should shape also the organization of production. To be competitive, the domestic supply base should extend its trans-national linkages to reach competence and knowledge available abroad.

This is true both for mature, consolidated economies – the European countries – as well as for developing countries.

These considerations pose a problem for SME dominated economies, where the dimension of firms prevent the possibility to count on firm-based international strategies. A possible solution is to push toward the internationalization of clusters: domestic firms could in that way pursue collective internationalization processes, strengthening their internal relationships and implementing new international linkages. For this kind of policy a strong institutional effort is required, not only to enforce the collective action within the clusters, but also to resolve the institutional gaps between foreign areas. A possible solution is the idea of transnational cluster implemented in neighbourhood areas – Cadses being one of the candidates - to minimize the requirement of institutional harmonization, given the likely cultural, social, historical and economic similarity, and to spread the benefits in a politically relevant area.

1.2 NATIONAL COMPETITIVENESS AND PRODUCTIVE INTERNATIONALIZATION

In the debate about the poor performance of the European economy, a key issue is identified in the low degree of international openness of the supply base. It is not only a question about the ability to penetrate into foreign markets, measured as market shares. The focus is more on the organization of production: the internationalization of the supply chain is seen as a key factor to face the global competition.

A high level of productive internationalization means, in fact, the opportunity to exploit and embed into the production process a wider spectrum of factors of production, from labor and competence, to research and innovation available abroad.

The question has to be considered from two points of view: 1) as active internationalization, showing the ability of domestic firms to organize their production using foreign factors, i.e. revealing the robustness of the entrepreneur's formula outside the domestic environment; 2) as passive internationalization, denoting the attractiveness of domestic firms and of the whole territorial system, for foreign firms and investments.

The determinant of the process are the strategies of firms. As far as the active internationalization is concerned, some domestic Italian firms are able to expand their productive capacity abroad due to their internal resources in term of knowledge, organization, management and finance. These are the multi-national or meta-national firms, which organize their production world-wide. They are able to actively fragment their production into different multi-national sites, depending on various factors well analysed in the literature: cost reduction, access to specific knowledge, access to intermediate and final markets. The most evident form of this Process is the building of new productive capacities abroad, through either the acquisition or the construction of new plants.

The degree of international integration of the firm is determined by size of the outgoing flow of investments. The appropriate measure could be the flow of investment in a given period, the size of the stocks or the number of employees, depending on the scope of the analysis. For the point of view of passive, or incoming internationalization, the relevant strategies are those of the foreign firms deciding to localize some of their activity in the country.

By summing up the international integration of the individual country-based firms, it is possible to obtain a measurement of the international integration of production of an entire national economic system, as is extensively done in empirical research.

The empirical evidence about the degree of internationalization of production shows that many European countries suffer from a lack of openness. If we use, as a proxy of the degree of openness, the amount of Foreign Direct Investments (FDI), we could confirm the poor level of international integration for the less growing European countries.

Let's take as an example the case of Italy: the country ranking in term of amount of FDI is much lower than its ranking in term of GNP level or in term of trade openness, both for ingoing and outgoing FDI.

As far as Italy is concerned, the low level of multi-national activity is usually explained by the characters of the Italian development model, namely the small size of the firms and the specialization in traditional sectors. In a scenario of globalization, Italy is suffering from the competition of countries with lower labor costs, differently from other countries, where the average size of firms is large and the specialization is on high-tech sectors. The scarce degree of internationalization seems to be at the same time also the cause of the difficulty of Italian system to follow the recovery path taking place for the other European countries.

The linkage between the organization of production and the multi-national foreign extension of the supply base has been largely investigated by the economic literature, starting from Dunning (1993). The availability of large size firms is a pre-requisite for the international organization of production through direct investments: the decision to implement productive capacity abroad involve sunk cost, as cost of information on the foreign market and institutions, establishment of new contracts in a different institutional contexts, implementation of plant and specific equipment.

Following the transaction cost literature, the risk for the firms increases with the institutional distance of the area where the investment is localized, stressing the role of economies of scale. The same is true for the financial dimension of the investment: the larger the firms, the higher the probability to have access to the credit market.

1.3 HOW SMES INTERNATIONALIZE THEIR PRODUCTION PROCESS

The low level of multi-national internationalization has a second possible interpretation. If the micro-economics of foreign direct investments requires large, multi-national firms, are economic systems with a prevalence of SME's prevented to follow a specific internationalization process? Or, in other words, internationalizing the national supply base has necessary to be obtained only through an increase in the size of firms?

In many European countries, even in countries pertaining to enlargement area and more precisely to the Cadses area, there is a consistent share of economic activities, which is scarcely captured by the theoretical framework of multi-national firms and by the empirical measure of foreign direct investments: it is the economic area covered by small and medium-sized enterprises, usually clustered in local system of production.

As far as the Italian economy is concerned, clustering of SMEs has peculiar features in term of social trust, cooperation and innovation, concisely known as the model of "industrial districts", which exhibited quite a better performance than bigger firms in recent decades.

The interesting point here is the degree of openness of these local system of production: they are in fact deeply involved in the international extension of productive activity. To better understand the process of international re-organization of small and medium enterprise (SME) it's useful to refer to the issue of fragmentation of production, in two different perspectives.

Industrial districts and clusters are the result of the fragmentation at local level: the breakdown of the supply chain into different phases and into different firms within the local system is the main features of this model of organizing the production. The economic and social literature on industrial districts (Becattini, Rullani 1993; Brusco 1994; Porter 1998) recognizes the specificity in the patterns of division of labour in SME production systems. These are systems where local market plays a crucial role in organization of the supply chain, in integration of different productive stages and in good matching between supply and demand of intermediate goods.

On the other hand, the feasibility to fragment the production process into different phases has played a role at international level, according to the "international fragmentation" theory (Arndt, Kierzowsky 2001). The "global value chain" approach (Gereffi, Humphrey, Sturgeon 2005) focus on the way the large, multi-national firms have re-organized internationally

their production. This led in turn to the globalization of the economy not only through international flows of capital and goods, but also through trade (Feenstra 1998). These two features have a different timing. Industrial districts and clusters appeared as a successful model of production in Europe since the sixties. The international fragmentation occurred years later and redesigned the world economic geography, with the emergence of new countries, which are today the competitors of the European districts. The question is then: given that European clusters were so successfully relying on the domestic fragmentation of the supply chain, why aren't they so successfully taking part in the international fragmentation of the global value chains? In the new landscape of global competition, these clusters are forced to change their internal organization. They have to face a stronger international competition and have to try to gain new competitive advantages. SME's clusters have to take advantages of greater availability of resources abroad in two complementary ways: through increased efficiency and through access to new knowledge. In other words, they have to participate to the international reorganization of the value chain within the general framework of productive fragmentation (Gereffi 2004). Is this process taking place? To answer the question, we have to look at international re-organization processes of SMEs without relying on the multinational firm as the only model for the global economy. Indeed, when analyzing only foreign direct investment (FDI) flows for European countries characterized by a wide presence of SMEs, despite a high export bent, the degree of international integration of production is very low; but if we analyse the growing intra- and interindustry trade especially with emerging economic regions in the world economy, we may infer the existence of international productive networks. This is particularly true for Italian clusters, where the trade in "district specific" intermediate goods with the area of Central-Eastern Europe, Mediterranean Basin, Far East and Central Asian countries reveals the international extension of their production organization. Our hypothesis is that the main way SMEs develop international linkages reflects the local di-vision of labour patterns: from this perspective, to analyse international production reorganization processes of SME systems, we have to look how the local value chain is slicing up in the global economy (Krugman, 1995). This theoretical perspective also has a corollary in understanding the competitive position in international division of labour. By looking at "kaleidoscope comparative advantage" described by Bhagwati and Dehejia (1994), the economic position is not only decided by the industry in which the local or national systems have specialised, but also by the specific segments of the value chain marked in local or national activities. In other words, in accordance with Hummels, Rapoport and Yi (1997), we prefer to speak of "vertical specialization" rather than traditional comparative advantage based on structural analysis.

More precisely, the structure of SMEs does not fit well with the general framework outlined above, the one used to measure the degree of internationalization of an economic system based on multi- and meta-national firms. Some of these firms, though of medium size, are playing a global competitive game. But as a whole this set of firms lacks sufficient resources to directly control the international extension of production. The growing literature on FDI is not suitable for analysis of SME clusters. Firms embedded in productive districts, even dynamic and network related ones, cannot usually afford the large amount of sunken costs required to establish new productive capacities abroad, signalled by direct investments. Thus, FDI are the proper indicator for large, multi- and meta-national corporations, but not for the international extension of production organization involving SMEs and clusters of firms. Surveys of the framework of Italian production show the mismatch between the sector detail of outgoing FDI and export specialization pattern of the Italian economy.

On the other end, industrial districts based their success, in economic and social performance, on an early domestic fragmentation of the value chain, confined within the geographical boundaries of the district. The technical feasibility of breaking down the supply chain, together with variability and sufficient sizes of intermediate markets for local firms positioned along the supply chain, led to the emergence of a highly specialized local system. This has been due to the exploitation of locally based externalities. In the Italian economy, for example, they became leaders in mature markets (the so-called "Made in Italy" sectors) due to the local fragmentation of production; more precisely, they were able to be innovators and competitors through the establishment of internal markets. Market transactions were not strictly confined within the local systems, but the emergence of these markets (dedicated machinery for textile or footwear makers) was the way to be dynamically competitive too, spreading

innovation and new knowledge along the supply chain. Within the local systems of production, each firm plays a different role in the supply chain. The role is two-fold: on the one hand, firms are complementary to each other in a vertical integration scheme; on the other hand, the many small firms compete with each other in their production. It is precisely this combination of coordination and competition that allows a dynamic performance of the local system, in terms of innovation, new products, knowledge growth and new employment. The crucial point for our reasoning is that the organization of production is made through market transaction.

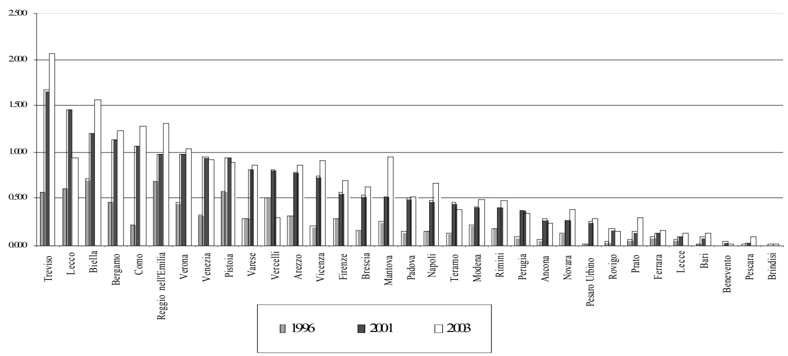
To proceed with empirical research, the appropriate tool to assess the extension of productive internationalization of districts should be the analysis of international trade flows pertaining to the districts, both imports and exports. The point is relevant but somehow neglected in the economic literature. An interesting line of study is the one on industrial fragmentation (Arndt, Kierzkowsky, 2001; Zysman, Schwartz, 1998), stating that if the internationalization process is made within a fragmentation framework, the analysis should refer to disaggregated trade flows. It is exactly the breakdown of the supply chain in technical strokes that corresponds to the local organization of production in "Made in Italy" manufacturing districts.

The focus is therefore on bilateral trade flows of intermediate goods between districts and foreign areas, both related to a specific value chain, as a signal of the existence of a district governed international network of production. long this line of research some scholars have used the source of Outward Production Trade (OPT) as an indicator of productive internationalization. OPT, or the opposite, Inward Production Trade (IPT) are a clear extension abroad of the supply chain; they are specific trade regimes, due to particular bilateral agreements for custom reduction. Though this pattern of internationalization has theoretical relevance, nowadays its use is limited to a very specific vertical integration pattern and its importance is dramatically reduced due to the new institutional framework. Indeed, this trade regime was used mostly with Easter European countries (EECs), now within the enlarged Europe.

To proceed with a more systematic analysis, a macroeconomic approach is needed to capture the process regarding the system of firms, the productive districts, and the different forms of the internationalization of productive processes here analysed. As in the internal organization, in the international

integration of production it is likely that districts use less resource-intensive tools and less formalized than FDI, such as productive agreements and market trans-actions. Given that these relationships are with foreign firms, they involve trade flows of intermediate goods. This process can follow different patterns, based on different outsourcing schemes: horizontal or vertical integration, collaborative agreements or pure market transactions. A systematic approach to measure then international extension of production of clusters is proposed in Corò and Volpe, with regard to Italian districts. Bilateral flows of intermediate goods pertaining to the correspondent supply chain are used to construct a measure of internationalization.
To give an example in the following figure is represented an index of internationalization of Italian districts of "Textile and Apparel", where the value of the index is the ratio between domestic employment and what we call "foreign induces employment" of the district. For a complete description of the methodology the reference is to Corò and Volpe (2004).

Figure 1. Productive internationalization index for Italian Textile and Apparel districts
Source: Corò and Volpe (2006)



1.4 EFFECTS OF PRODUCTIVE OUTSOURCING ON LOCAL ECONOMY

Given that SME's process of internationalization is different from the large multinational strategy, a legitimate question is whether the effect is also different. The answer should be divided following two different perspective: one from the point of view of the domestic cluster being internationalized, i.e. the effect on the domestic economy; the second from the point of view of foreign areas taking part into the new international organization.
The second perspective is the less investigated, but the simpler of the two: in fact for a country still in a development perspective, as many countries in the European enlargement area, simply taking part to an international market is itself and advantage. It means to have access to new market, to participate in productive relationships which, through learning and technical upgrading, increase competence and knowledge. Many researchers studies confirm the positive effects of multi-national presence on the local economic system of the hostel foreign area.
The first perspective is the more intriguing. The issue of whether international reorganization has positive or negative effects is widely debated. Many, labelling the process of production international outsourcing as "delocalization" have the fear that the process is causing a loss of employment, value added and competence. The question is even more relevant for cluster-based economies. Given the role of local relationships between firms in the cluster, the fear is that a process of re-localization abroad of some manufacturing activities is destroying the cohesion of the cluster; negative effects could take place in term of social capital, relationships with the local community, local labour market and innovation. Some researches on Italian economy, on the contrary, give some preliminary insight, suggesting that does exist a positive association between productive internationalization and economic performance. The higher the degree of supply internationalization, the lower the decrease in manufacturing employment, the higher the total income of the clusters, the higher the level, and consequently the wages, of the employment demanded. Within Italy, the local economies more involved in the delocalization process in the '90s are the North-East regions: they show a higher employment rate with respect to the rest of the country and in these area the loss of employment in the manufacturing sectors more involved in

the delocalization process has been the less severe. There is also the confirm that the demand of labor is shifting toward more skilled workers: this is measured in term of increasing demand of business services, in term of increasing productivity and wages. Even the effects on exports seems positive, with an increase in the export, toward the foreign areas involved in the delocalization process, of products technologically related to the Made-in-Italy sectors. There are of course some negative effects, as well. The average quality of products has not increased, given that the average price of Italian export has been stable, a signal of competition still based on production costs. Also the rate of domestic investments has lowered, a signal of how foreign investments are seen as substitute, not complement, of domestic investments for competition and innovation.

1.5 GOVERNANCE OF OUTSOURCING PROCESSES

As a consequence of our reasoning, we can conclude that the process of internationalization is taking place with a non-reversible path and this is also true for SME and even more for local agglomeration of firms. Knowing that the effects of this process could be positive, the following issue is how to govern this process, to mitigate the negative effects and to augment the positive ones.

There is a clear evidence (see later in the book the evidence of a direct survey conducted in the Cadses area) that firms themselves are demanding assistance to qualify their international relationships, given that their individual competitiveness is increasingly relying on the quality of the network, shaped by the division of labor and activities, where they are embedded. If the network relationships are international, the target to develop stronger linkages is even more complex.

A successful governance of the internationalization process has to implemented at two levels.

The first is a domestic intervention, to develop new competence and skills, to offer new functions and services, to build new infrastructures, not only physical ones but also cultural, technological, logistic and organization infrastructures. This is essential to assist and enforce an upgrading process based on creative and relation-based factors. More precisely, specific policy for mature, consolidated cluster looking for an increase of their

competition position in international markets – the upgrading process – should consider the following district specific policies:

I.) implement infrastructure and services to increase the efficiency of the relationships between firms, as logistic and transport platforms, devices to simplify custom operations, to increase security and contractual feature of economic transactions, to develop new communication technologies;

II.) develop educational offer for technical and professional activity, to increase the competencies in transferring technologies, in quality certification, in trade mark and intellectual property right enforcement;

III.) develop cultural exchange and action to increase the coherence between firms, actors and institutions and stakeholders.

The second level is an intervention with the “hostel” economies, to increase the harmonization and coherence between different international areas. This is important for consolidated districts following an upgrading process, but is also fundamental to candidate less consolidated economic system to take part to an international supply chain. Some spontaneous process are already taking place. In the Italian case, for example, single districts are pursuing a real and systemic international re-organization of production, through “twins” and institutional partnerships. It is the case of the extension of the supply base of Treviso in the Rumanian region of Timosoara, governed through the local entrepreneurial confederation (Unindustria Treviso), following a process initiated by single firms. Or the case of the international extension of the electromechanic district of Vicenza to Samorin, in Slovakia. Or the partnership between the furniture district of the Italian North East in the Brasilian region of Uberlandia, in the state of Minas Gerais.

But a systematic institutional policy is still lacking, even in a district oriented economy as the Italian one.

1.6 INTERNATIONALIZATION POLICIES FOR CADSES AREA

Given this demand of domestic policy for internationalization, a common space in transnational policy is emerging. The promotion of trans-national cluster could be a win-win policy for neighbour countries, with a sufficient degree of similarity. The countries with consolidated clusters, looking for an international extension of their supply base, will take advantages of

relationships assisted by collaborating institutions in the area; the countries with less consolidated supply base could benefit from the opportunity to take part into the other country upgrading cluster. How to promote this kind of mutual policy in the Cadses area? Our proposal is to use a technological device, the portal illustrated in the following sections of this publication, which has two basic advantages:
1) it has a small cost in term of implementation;
2) it relies on technological and communication technologies which in se are promoting an upgrade of the firm taking place into the process of virtual matching.
The direct surveys conducted on firms in the area demonstrates how the firms have some competence in the using of such technologies – even if they have to be strengthen – and how firms are really demanding high quality international productive relationships. The proposed portal and the policy measures already in place to make this policy effective could be only the first step of a transnational cooperative policy aimed at the promoting the competitiveness of the firms in the Cadses area.

REFERENCES

Amin A. (1993), "The globalization of the economy: an erosion of regional networks?", in Grabher G. (a cura di), The embedded firm. On the socioeconomics of industrial net-works, Routledge, London

Arndt S.W., Kierzkowsky H (eds.), 2001, Fragmentation. New Production Patterns in the World Economy, Oxford, Oxford University Press

Barba Navaretti G., Castellani D., 2002, Does investing abroad affect performance at home? Comparing Italian multinational and national enterprises, Milano, Working paper Centro Studi Luca D'Agliano

Becattini G, Rullani E, 1993, "Sistema locale e mercato globale" Economia e Politica Indus-triale 80 25 – 48.

Bhagwaty J., Deheljia V.H., "Free Trade and Wages of the Unskilled", in Bhagwati J., Koest-ers M. H. (eds.), Trade and Wages, Washington D.C., The American Enterprise Insti-tute Press, 1994.

Brusco S. (1994), "Sistemi globali e sistemi locali", Economia e politica industriale, 84

Brown J.S., Duguid P. (2001), "Knowledge and Organization: a Social-Practice Perspective", Organization Science, Vol. 12, n. 2, March-April

Cooke P., Morgan K. (1994), "The creative milieu", in Dodgson M., Rothwell R. (eds.), The Handbook of Industrial Innovation, Edward Elgar, Cheltenham

Corò G., Volpe M., (2004), International fragmentation and cooperation policies among local productive systems, Sase, George Washington University

Corò G. e M. Volpe (2006), "Apertura internazionale della produzione nei distretti italiani", in Tattara G., G. Corò e M. Volpe (eds.), "Andarsene per continuare a crescere. La delocalizzazione come strategia competitiva", Carocci.

Doz Y., Santos J., Williamson P., 2001, From Global to Metanational, Boston, Harvard Busi-ness School Press

Dunning J.H. (1981), International production and the multinational enterprise, Al-len&Unwin, London

Feenstra R.C. (1998), "Integration of Trade and Disintegration of Production in the Global Economy", Journal of Economic Perspective, Vol. 12, Number 4.

Gereffi G. (2004), "The Global Economy: Organization, Governance, and Development", in Neil Smelser N. and R. Swedberg (editors), Handbook of Economic Sociology, 2nd edi-tion, Princeton University Press and the Russell Sage Foundation.

Gereffi, Gary, John Humphrey, and Timothy Sturgeon. 2005. “The Governance of Global Value Chains.” Review ofInternational Political Economy, 12:1.

Graziani G., 2001, “International Subcontracting in the Textile and Clothing Industry”, in Arndt S.W., Kierzkowsky H (eds.), 2001, Fragmentation. New Production Patterns in the World Economy, Oxford, Oxford University Press

Hummels D., Rapoport D., Yi K. (1997), “Globalization and the Changing Nature of World Trade”, Chicago, University of Chicago paper

Ice-Reprint, 2003, L’Italia multinazionale, Roma, Ice

Ietto-Gilles G., 2002, Transnational Corporations. Fragmentation amidst integration, London, Routledge

Kogut B. (1985), “Designing global strategies: comparative and competitive value-added chains”, Sloan Management Review, summer

Krugman P. (1995), “Growing World Trade: Causes and Consequences”, Brooking Paper on Economic Activity, 1

Levitt T. (1983), “The globalization of markets”, Harvard Business Review, May-June

Porter M. (1998) “Cluster and the new economics of competition”, Harvard Business Review, November- December

Sabel C., District on the Move. Note on the Tedis Survey of the Internationalization of District Firms, preliminary paper, August 2004,

Savona M. and R. Schiattarella (2004), “International relocation of production and the growth of services: the case of the “Made in Italy” industries”, Transnational Corporations (Vol.13, No.2)

Tedis-Formez (eds.), 2002, Sistemi locali di sviluppo e piccole-medie imprese alla prova dell’integrazione europea: dall’analisi alle politiche, Venezia, Venice International University.

Zysman J. and A. Schwartz, ed. (1998), “Enlarging Europe: The Industrial Foundations of a New Political Reality”, University of California International and Area Studies Digital Collection, Research Series #99, 1998.