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FDI into Regional Integrated Area and Trade; the investigation through Japanese car investment in the UK.

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Contents

Introduction

In spite of the efforts to globally liberalise the international trade under the General Agreement on Tariffs and Trade / World Trade Organisation, the regional economic integration becomes more and more important in the world economy (De Melo & Panagariya, 1993, Neal & Barbezat, 1997, Hirst & Thompson, 1999, Gilpin, 2000). The regionally integrated area through the internal liberalisation does not only accelerate the intra regional trade, but it also attracts the inward foreign direct investment (FDI), sometimes, at the expense of the non-member countries. Among these situation, nobody could reject the European Union (EU) is the most advanced scheme, and it is confirmed that the development of the European integration under the EU has attracted the inward FDI (United Nations, 1993, European Commission, 1998). At the same time, the Single European Market (SEM) removed the non-tariff barriers, and facilitated the intra-regional trade (European Commission, 1997). The multinational enterprises (MNEs) may well play a part of such increase through the intra-company trade or the pan-European strategy.

Since the trade and the FDI are the methods to serve goods and services for foreign markets, the relationship between them is one of the main topics for the international business scholars. For example, the product life cycle model of Vernon (1966, 1979) suggests that the export from the home country is substituted by the FDI at the matured phase of the product in question, and the home country comes to import it from the lowest cost point at the standardised phase. The macro economic approach of Kojima (1978) insists that the FDI facilitates the trade between the home and host, as far as companies in the comparative disadvantage sector of the home country invest in the comparative advantage sector of the host country. The internalisation model by Buckley and Casson (1976) emphasises MNEs intend to reduce the transaction costs through the intra-company trade, and this suggests FDI would increase the vertical intermediate trade flow. In the context of the EU integration, the relationship between FDI and trade are affected by a various factors, including the EU integration itself. In actual, the empirical investigation by the European Commission (1998) points out that there are various possibilities of the relationship between FDI and trade, and that the industry- and country-specific factors influence the results of FDI on trade. This European Commission's research, and others, focuses on the trade of the goods directly concerned the FDI, and the exports from the host country, whereas gives less attention to the related sector, and to the import of the host economy. However, MNEs surely consider the regionally integrated area both as the market to supply, and as the basis to procure the necessary inputs, which are not always supplied from its own subsidiaries, but also from those at arm's length. Therefore, we should consider the relationship between FDI and trade not only from the export side, but also from the

import side.

This paper addresses the research theme above mentioned through examining the issues raised from the review of Japanese car FDI into the UK. Our approach is not based on the aggregated FDI data, which is often used in the previous works, but assesses the managerial practice of Japanese car MNEs and its impact on UK components trade. In other words, this paper intends to make clear the basis of the result of trade at the national level from the examination of MNEs' strategy and operation. Thus, the data and information collection should be appropriate for this approach. The UK car production and trade are derived through the statistical data published by the industry organisation, Society of Motor Manufacturers and Traders (SMMT), while the data and information on the strategy and operation of MNEs are obtained through a series of interviews with Japanese car plants in the UK, their parent offices in Japan, and the trade unions by this present author, as well as through the UK and local government reports, and so on.

The analysis will take the following structure. First, we will summarise the literature concerning the regional economic integration, FDI, and trade, and give the justification of our theme setting and approach (Chapter II). Then, Japanese car FDI into the UK will be confirmed, showing the contribution for the revival of the car production and export of the UK. Here, the picture is put in the context of the UK car industry as a whole including the trend of the trade (Chapter III). The following chapter IV will suggest the two *paradoxes* which are derived from the summary in the chapter III; that is, why Japanese car MNEs can succeed in the UK, and why the UK trade balance in the parts and components sector dived into deficit along with the revival of the car production and export. These questions will be answered in the chapter V. The concluding remarks will be given in the final chapter.

Literature Survey

Because of the mutual influence between trade and FDI concerning the regionally integrated area, there are theoretical and empirical works. Kindleberger (1966) first suggests the trade creation effect of the customs union leads the investment diversion within the region, while the trade diversion effect brings the investment creation from non-member countries. Yannopoulus (1990) extends the model of Kindleberger, and lists four types of FDI responding to the regional economic integration. First is the defensive export substituting investment, which replaces export with FDI, and that reduces the export from the rest of the world through the increase of the regional production. Second is the reorganisation investment, which adjusts the existing facilities to reflect

the free intra-regional trade, and that accelerate the intra-regional trade based on the plant and country specialisation. Rationalised investment, which increases the value adding activities within the region, is the third case, and that may well decrease the import from outside. The final type is the offensive export substituting investment, which gains the first mover advantage through FDI, and the effect on trade is dependent on the regional market growth.

The various scholars and organisations conduct the empirical investigations. UN (1993) summarises the trend of FDI into the EU from the USA, and Japan, and among the EU countries, and shows the vertical integration by US MNEs within the EU before the SEM. The European Commission (1998) reports that the increase of the intra-industry trade of the EU has something to do with the FDI and the operation of MNEs, and the SEM might well lead MNEs to take the efficiency-seeking FDI. Dunning (1997) sums up various issues concerning the SEM and FDI, and points out, as one of the conclusions, that FDI and trade are complementary with each other. In more general context, though concerning the regional integration, FDI and trade, Kumar (1998) analyses the determinant factors influencing the export-oriented foreign production by US and Japanese MNEs. He finds the membership of the host country to the EU as the factor determining the FDI with the purpose of the third-country-oriented production at the highest rank. All of them look at the export by MNEs as the trade factor influenced and influencing the regional economic integration. Indeed, Norman (1995) surveys Japanese FDI into EU, and suggests the importance of the local sourcing for the EU as a whole. This indicates that the import, as well as the local procurement has an important meaning for the EU economy, but still he does not pay attention to the host country implication of the local sourcing. The common features of the works above summarised are two folds. The first one is that they focus mainly on the influence of FDI on the export, but not on the import. Another is that the research interest is directed to the decision making of FDI, but neither to the process of, nor the consequence of transplanting the management methods.

Japanese car FDI has already attracted a great attention by scholars, and the issues raised to investigate are wide spread, as reflecting the impacts on a range of aspects in the industry and economy. Thomsen and Nicolaides (1991) give the special appendix on the case study of the automobile sector in their book on Japanese FDI in Europe. Their approach is based on the product life cycle model of Vernon, and suggests part of the car export from Japan would be substituted by FDI. They further expect the export from the UK to the rest of Europe, but do not consider the impact on the suppliers and the components trade. The suppliers' relationship is one of the most important elements for the car assembler to keep and improve the competitiveness, and this is also

true for Japanese car MNEs in Europe. Salvadori (1992) gives a whole summary of European car industry under the SEM from manufacturing to marketing, and suppliers. He suggests the impact of Japanese FDI as the opportunity for European suppliers as a whole, though the difference of the implication for different national suppliers is not pointed out. Sachwald (1995) pointed out the issues concerning the suppliers as the significant but difficult question both for Japanese and European companies. Japanese MNEs have to transplant their methods of business, while European suppliers also have to learn them in order to be the first-tier suppliers. Some reports show the actual experience of British suppliers with Japanese MNEs, and mentioned the difficulty of the former to keep and upgrade their relationship with the latter (Lamming, 1994, National Economic Development Office, 1993). Here, all the works agree the importance of Japanese FDI on the suppliers, but little analyse the implication of the different impacts among the member states of the EU and the components trade in the EU.

From the above summary of the literature, it can be justified of our research to look at Japanese car FDI into the UK, and its implication through transplanting the management method on the UK with special attention to the suppliers and the components import of the UK.

Japanese Car FDI into the UK

Now, we start to summarise Japanese car FDI in the context of the UK car industry. Three Japanese car MNEs, Nissan, Honda, and Toyota, decided to produce cars in the UK in the 1980s (Table-1), mainly motivated by the protectionism pressure and the growth potential brought by the SEM, although the actual decision making time is different with each other.[1] Nissan established Sunderland plan, North East England, and commenced the knockdown car production in 1986. The production, however, shifted to the full line assembly from 1987, and increased the local contents to 60 % in 1988, and to 80% in 1991. Honda made a partnership relationship with British Leyland, and offered the technology for the small car production from 1979. Despite of the organisational change of British Leyland to Rover group, Honda kept the close relationship with Rover through the various methods. Rover did not only produce its own cars based on Honda's technology, but also was licensed to assemble the cars for Honda's European sales including the UK market. Honda set up a plant in Swindon, South England, in 1986, so that it could first operate the pre-delivery inspection of Honda cars produced by Rover. Swindon plant expanded the facility to produce the engines provided to Rover plants in 1989. The full line production of Honda cars by itself finally started in 1992, with the supply of some main components such as the diesel engine, and the body panel from Rover. Toyota, though the largest car producer in Japan, was the most cautious about

European production, but decided to establish UK plant in 1989. The car assembly plant was established in Burnaston, West Midland of England, and the engine plant in Shotton, North Wales. The first car was rolled off at the end of 1992.[2]

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Table-1

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Japanese car MNEs has been expanding British production and the exports mainly to the Continental Europe (Graph-1). In 1986, the production of Japanese cars in the UK started with just only 5,000 units, but the figure increased in the 1990s. It became more than 300,000 units in 1993, when three Japanese car MNEs started the full line assembly. The figure in the last three years until 2000 was more than half million units. Along with the growth of the production, the share for the UK car production also increased from merely 0.5 % in 1986 to more than 30 % in 2000. More impressive is the exports from the UK plants of Japanese MNEs. The initial volume of export was 11,000 units in 1988, which was conducted only by Nissan. The total export exceeded 200,000 units in 1993, when Honda and Toyota also became the exporters from the UK, as well as Nissan, and reached more than 400,000 units during the period between 1998 and 2000. The exports of three MNEs represent more than 70 % of UK production by Japanese firms, and share more than 35 % of UK exports during the 1990s. In sum, Japanese car MNEs make use the UK as the platform to supply for European markets, as well as the UK market, and contribute to the production and export of cars in the UK.

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Graph-1

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From the above summary, it might well be concluded that, assuming the international competitiveness of Japanese car industry in the 1980s, when its share in the global car production rose from 14.1% in 1970, and 24.6 % in 1980 to 27.6 % in 1990, Japanese car FDI into the UK was relatively easy task, and positively affected on the UK car industry.[3] However, if we look at this picture from the wider context both of the UK car industry, and of Japanese car MNEs, our assessment should add the success with some reservation. So, we will further confirm the background of Japanese car FDI.

First point is concerning the previous experience of Japanese car MNEs in Europe, and the stagnant of US car MNEs in the UK, when Japanese car MNEs decided to invest into the UK. Here, it is

worth to mention that the FDI into the UK is not the first attempt in Europe by Japanese car MNEs. As the knockdown production, for example, Toyota invested into Portugal and Ireland. Toyota has possessed the joint venture, though as a minority share holder, in Portugal from 1968, while it operated the knockdown car production in Ireland between 1973 and 1983 (Toyota, 1987). However, they did not play the central role for European business, due to the minority share holding, or the knockdown production (Takahashi, 1997). Even if we look at the full line assembly project, there were some failure before British venture. Nissan took part in capital of the Motor Iberica in 1980, and became the majority (54.66 %) share holder in 1982. In addition, Nissan started the joint venture with Alfa Romeo in Southern Italy from 1980. However, both of them were not successful. The Motor Iberica has long been in deficit until the 1990's. Italian venture had never reached at the full capacity production, and were sold to Fiat (Darby, 1996, Pallares-Barbera, 1996). Furthermore, we can add the case of Suzuki in Spain as the example of the failure of Japanese car FDI in Europe (Tokado, 1994). The fact that the trial of Japanese car MNEs to assemble cars in Southern Europe resulted in the failure suggests that Japanese car FDI into the UK does not automatically guarantee the success in European business *a priori*. Another concern is the stagnant of British subsidiaries of Ford and GM in the 1980's, such as the trend of the UK production and export, which will be seen soon (Graph-2). Especially, the exports of both subsidiaries in the second half of the 1980's were almost nil. This suggests that the UK was not naturally favourable location for the car production and the platform of export to the Continent, when Japanese car MNEs started to invest in the UK for the full line assembling.

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Graph-2

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Second, we should assess Japanese FDI in the context of the UK car industry for the last three decades until 2000. The UK was the second largest car producer in the world after the USA after the Second World War, but from the early 1970s its fortune was lost before Japanese car MNEs came in the 1980s. Graph-3 and 4 clearly shows the decline of the car production and export until the 1980s. The UK car industry halved the production from 2 million units in 1972 just before the EU membership to less than 900,000 units until 1982, while the deterioration of exports was more serious, as the passenger car exports declined to 180,000 units in 1986 from the peak with 750,000 units in 1971. On the other hand, the imports and its share in new car registration jumped up to 1 million units and 55 % until the end of the 1970s, respectively. The situation of the UK car production and trade relatively turned favourably from the mid-1980s. 1984 is the bottom of the car production in the UK, which gradually returned to the level of the previous peak in 1972. The

figures in 1998 and 1999 were almost the same as those in the early 1970s with 1.7 million units. The performance of British export is more impressive than the revival of the production, and the three years to 2000 exported more than 1 million units. Most of the last two decades until 2000 imported 1 million cars or more. Thus, the market share of the imported cars has been always more than 50 %. It was more than 70% of the three years in the four years between 1997 and 2000.

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Graph-3 & 4

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The point to be further mentioned here is the situation concerning the suppliers. In spite of the ruin of the car manufacturing in the 1970s, it was often said that the parts and components industry in the UK was much better than the assembler (Bhaskar, 1979). This can be confirmed by the fact that the trade balance of the parts and components had been in surplus in the 1970s and the first half of the 1980s. Since the parts and components include various products such as electrical equipment, bodies, engines, and so on, it is difficult to clearly show to what extent each of the parts and components contributes to the trade surplus.[4] Despite of such limit, it is still true that the parts and components trade partly offset the deficit of the assembled cars until the mid-1980s. The situation, however, turned from the mid-1980s, since when the car manufacturing experienced the favourable upturn. The trade balance of the car parts and components became deficit first in 1986, and has never returned back to surplus. Indeed, the export of the parts and components has constantly increased for the last one and half decade till 2000, the growth of the import exceeds that of the export. As a result, the parts and components trade put the burden on the UK trade balance with the assembled cars, rather than offset the later as in the 1970s. Thus, it can be said that the suppliers in the UK worsened the performance, contrary to the relative revival of the car production from the mid-1980s (Graph-5).

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Graph-5

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Two Paradoxes

The previous chapter looked at Japanese car FDI into the UK from a broad perspective. Japanese car MNEs invested in the UK, and expanded the production and export smoothly. However, we can point out two *paradoxes* from the precise consideration, which showed that the UK car industry including US car MNEs had declined in the 1970's and the first half of the 1980's, and that the

component trade balance deteriorated to deficit from the mid-1980s. The *paradoxes* are follows; that is, *why Japanese car MNEs could succeed tin the UK*, and *why the UK car component trade dived into deficit in the process of the revival of the car production and export*. Before the analysis of these two *paradoxes*, we will explain the reasons why these two issues are *paradoxes*.

First, the success of Japanese car MNEs in the UK can be said a kind of *paradox* from the wider perspective including both their experience in Europe, and the US counterparts' operation in the UK. The econometric analysis generally tends to use the FDI data as the proxy of decision making by MNEs, but the cases of Japanese failure summed up in the previous chapter suggest that the FDI data includes the failed attempts by MNEs, too. This means that there is a gap between the investment decision by Japanese car MNEs and the expansion of the production and export, since the former does not automatically lead the latter. The fact that the UK production and export by US MNEs were expiring in the 1980s, when Japanese car MNEs decided to invest into the UK, indicates the UK was not always the appropriate location to produce and export cars. The previous experience of Japanese car MNEs in Europe might well indicate the potential of their failure in the UK, and the unfavourable conditions for the car production and export in the UK in those days were likely to further strengthen the possibility of the failure. However, Japanese car MNEs have relatively smoothly expanded their production and export. Therefore, we could point out the gap between the FDI decision and the success under the inferior situation as the first *paradox*.

The second *paradox* is concerning that the UK car parts and components trade balance declined to deficit in spite of the revival of the UK car production (Graph-6). We can generally expect that the suppliers' performance may well improve along with the customers' production, but the late 1980's and the 1990's gave the opposite picture. This *paradox* can be further strengthened by the fact that the suppliers in the UK did not show so poor performance as the car manufacturing in the 1970's, and earned the trade surplus. Second, the new production system in the auto industry also made to expect the positive influence of the car production recovery on the suppliers. This is mainly due to the Just-in-time (JIT) parts and components delivery requirement, which actually led the suppliers' agglomeration in the USA (Kenney & Florida, 1993). Third, the local contents condition, which requires car MNEs to locally spend more than 80 % of total value at the factory, also seems to strengthen the *paradox*. Fourth, the new international trade theory predicts the agglomeration of the industry in a certain area under the conditions that scale economy has big effect and freer trade is realised (Baldwin, 1994, Krugman, 1991). Although this prediction does not directly concern with the trade balance, the recovery of the UK car production along with the SEM may well be expected to attract the suppliers, too. Fifth, since a part of the famous Diamond by Porter, which can be the

basis of the national competitiveness, is constructed of the suppliers industry (Porter, 1990), the production revival in the UK car industry should be based on the improved competitiveness in the suppliers. Therefore, the simultaneous development both of the car manufacturing revival and the decline of the parts and components trade balance seems to be the *paradoxical* movement from the various perspective.

From the statistical data, we can easily recognise that Japanese MNEs have been expanding the car production and export, and, to a certain extent, that contributes to the revitalisation of the UK car industry. However, it is also possible to show the success of Japanese FDI and the "failure" of the UK suppliers as a kind of *paradox* from the consideration of wider perspective. Thus, it is our task to further analyse the *paradoxes* above mentioned.

Explaining Two *Paradoxes*

The Success of Japanese Car MNEs in the UK[5]

As Dunning (1988, 1993) suggests, any FDI project needs the combination of three advantages, that is, the ownership advantage, the internalisation advantage, and the locational advantage. This is also true for the case of Japanese car FDI into the UK, and we will consider them in this section. Here, we should give special attention to the transferability of the production method, which, as seen soon, was unique in those days.

The first advantage of MNEs to possess for the success of the FDI is the ownership advantage, which enables the company concerned to compete with the local firms including other MNEs. The ownership advantage of Japanese car MNEs is the flexible production system, developed in Japan, and sometimes called as "lean production system" (Altshuler, Anderson, Jones, Roos, & Womack, 1984, Womack, Jones & Roos, 1990). The flexible production system is based on the different management method of the labour and suppliers' relationship from the conventional mass production system, which had occupied in the European and US car industry. The flexible production system raised the productivity, improved the quality, and increased the variety of products. So, Japanese cars could compete with lower price at higher quality. As a result, Japanese car industry aggressively increased the exports from Japan to the USA and Europe since the 1970's, which caused the trade friction. The point to be emphasised here is that the high productivity based on the flexible production system is the necessary condition for FDI, but not the sufficient one. This is clearly suggested by the failure of Japanese car FDI in Southern Europe before the UK projects.

Thus, we should look for the conditions to explain the success of the UK venture, which are further based on the other two advantages, the internalisation, and the location advantages.

The comparison between the failure and the success of Japanese car FDI in Europe suggests the second advantage necessary for FDI, that is, the internalisation advantage. The flexible production system was formerly unfamiliar with European competitors, workers, and suppliers. The workers' involvement and the co-operation with suppliers are one of the most important factors for the flexible production system, but those with experience of the conventional mass production system were not co-operative. The allocation of workers under the flexible production system required to change and / or to share the jobs and the competences in a plant, and this could raise the productivity. Sometimes that would lead the reduction of the payroll. Thus, the workers in the existing plant were reluctant for the introduction of the flexible production system. This is one of the reasons of the previous failure in Spain and Italy.[6] At the same time, the suppliers' relationship under the flexible production system was also different from the mass production system. The flexible production system requires smaller number of the first tier suppliers to closely collaborate with the assembler, so that they can raise the productivity, and improve the quality. During the period of the model in question, the suppliers are requested to reduce the price of the parts and components, and to contribute to keeping and improving the competitiveness of the assembled cars. Therefore, the suppliers have to permanently improve the productivity for their own business benefit. This is quite different from the mass production system, under which the suppliers tend to offer the lowest price at the contract, but to raise the profit through gradually raising the price during the life time of the model concerned. Thus, the transferability is the significant question for the success for Japanese car MNEs on the foreign soil.

Here, the entry mode played an important role to internalise the workers' involvement and the suppliers' collaboration for the flexible production system. All three Japanese companies took the greenfield investment for the UK plants, although Honda took a partnership with British Leyland before establishing its own full line production plant. The greenfield investment provides more suitable conditions for transplanting the flexible production system than the joint venture or the acquisition, since it enables the MNE in question to construct the plant, make contracts with the suppliers, establish the labour management including the relationship with the trade union, and so on, from the scratch with its own intention (Buckley & Casson, 1998, Hennart & Park, 1993, Woodcock, Beamish & Makino, 1994). Among other elements, the labour management issue may well be one of the most important ones, and the existing plants also had to improve their workers relationship (Starkey & McKinlay, 1993, Mckinlay & Starkey, 1994). Here, it is worth to suggest

that the acquisition of Rover group by BMW resulted in the failure, while Honda did not wish to buy the full ownership from British Aerospace, which had possessed the full ownership of the Rover group.[7] In other words, the entry mode is the key element for Japanese car MNEs to realise the internalisation advantage.

The ownership, and the internalisation advantages do not explain the reason why Japanese auto MNEs chose the UK for their own full line assembly plants. Here, we should make clear the final advantage, i.e. the locational advantages, which the UK offered for Japanese car MNEs, especially in the context of the transferability of the flexible production system. The locational advantages of the UK include various elements such as the relatively cheap labour force, free access to the Continental Europe, the government support for Japanese FDI, the language, English, and the availability of the middle managers with the experience in the auto industry. Other European countries may well offer some of them, but the UK provides all of them. From the consideration of the transferability of the flexible production system, the last two advantages give the special advantages for the UK as the car investment site, and it is worth to explain them more deeply.[8] As noticed above, the flexible production system was not familiar in Europe, transferring it was difficult task for Japanese car MNEs. The involvement of the workers and the suppliers to improve the productivity needs them to understand the system itself, and the close communication is more important than any other elements (Abo, 2001). Two facts that English is the first foreign language of the Japanese, and that Japanese MNEs had previously experienced the full line production in the USA before European venture are the basis of Japanese MNEs to consider that English is quite important for the close communication. On the other hand, the availability of the middle and upper manager with the business experience of the car production is another significant advantage the UK offered. Although the line workers with the experience in other car company are not always welcome not only by Japanese car MNEs, but also by US ones,[9] the middle and upper managers with the experience are necessary for the car company. As mentioned in the previous chapter, as the UK car industry had already declined before Japanese MNEs came, the restructuring process released the amount of managers. At the same time, some managers had been unenthusiastic to work under the conventional mass production system, and found Japanese plants as a challenging opportunity. On the other hand, since the car industry on the Continent was not so deteriorated as in the UK, it was harder for Japanese companies to hire the managers with the similar conditions as the UK counterparts. One Japanese manager of Japanese car MNE summarised this situation as follows;

> In the UK, we could be relatively easy to find the managers with the experience of the car business for our plant, while those in, for example, Germany or France were more proud to work in the

company of their own country, rather than in Japanese plant.

The above three advantages, which are closely related with each other, enabled Japanese car MNEs to transplant the flexible production system to their UK plants, and to raise the production and exports. At the same time, it should be emphasised that Japanese car MNEs actively modified the locational disadvantage in the UK such as the poor relationships between the company and the workers to more favourable ones through constructing the appropriate business structure, which the greenfield investment made possible. In other words, MNEs are not merely a passive entity to respond the environment and its change, but also, to some extent, an active creator of business conditions.

Here, some comments should be added on the effects of Japanese car MNEs to improve the locational conditions. The transfer of the flexible production system by Japanese car MNEs does not only affect on Japanese plants, but also the whole of British car industry, to certain extent. The success of Japanese plants in the UK influences the UK car industry through two routes. One of them is the direct one such as the construction of new relationship between the workers and the company, and the productivity improvement of suppliers.[10] Another is the indirect path such as the heavy competitive pressure on the existing plants in the UK to introduce the flexible production system.[11] The effect on the suppliers, however, is not always the positive one such as the improvement of the UK suppliers' productivity. As the other side of the same coin, it is closely related with the second *paradox*, i.e. turning down of the trade balance of the car parts and components to deficit, which we will see in the following section.

The "Failure" of the Suppliers in the UK

The recovery of the car production and export did not succeed to keep the competitiveness of the suppliers in the UK, as the deterioration of the trade balance suggested. Indeed, the trade deficit is caused by the growth of the import exceeding that of the export, but it is still a paradoxical situation in the context of the car production revival. So, this should be further explained, but no previous work tries to answer the question.[12] We will look at this issue, and make clear the mix of four elements is important.

The first is concerning the significance of transferring the flexible production system to the UK. The JIT delivery practice, which is one of the examples of the flexible production system, did not play such a role to attract the suppliers in the UK as expected. The JIT delivery is quite useful

method of the parts and components procurement in Japan, where the land price is very high, to reduce the cost of the storage. At the same time, the assemblers possess the monopolistic bargaining power against the suppliers, due to the large volume of the production, and can easily force the suppliers to deliver the parts and components for their plants on the JIT basis. These conditions are not met in Europe. An interview at UK plant of Japanese car MNE told that "because of the relatively small lot of the components procured from European suppliers, we are at the weak position against them. So, the specification of cars should be sometimes adjusted to the procured components." This suggests that Japanese plants could not fully transplant the JIT parts and components delivery into the UK. As a result, they sometimes use the milk run delivery system, by which the assembler itself goes to collect the parts and components (Lamming, 1994). There is another method for the components delivery, which uses the parts and components distribution centre. The suppliers are asked to deliver the parts and components to this distribution centre. The assembler itself breaks them down into batches to the production schedule, and delivers them to the plants on the JIT basis. In other words, the JIT delivery is just used between the distribution centre and the plants (Honda Motor Europe, 1999). Moreover, it is reported that the procurement policy of the UK plants is not so effective to pull the suppliers to the UK, even in the process of the production recovery, and the introduction of the flexible production system by the UK plants including US MNEs (Wells & Rawlinson, 1992).

The local content requirement for the transplants to locally procure more than 80 % of the post factory price has some limit in the context of the EU integration. Even if the UK government actively set the local content, it does not restrict to the inputs in the UK, but in the EU. Thus, the transplants are free to purchase not only from the UK-based suppliers, but also from the Continental ones (Foley, Hutchinson, Herbone & Tait, 1996). It can be said that the local content may well reduce the import of the parts and components from Japan, but not those from other European countries.

The second point is concerning the procurement policy of the car assemblers, and its change. The exchange rate volatility between the pound-sterling and the continental currencies or Euro forced car assemblers in the UK to increase the parts and components imports. As seen before, the revival of the UK car production was partly led by the increase of the export, and this is more so for the case of Japanese MNEs, which export around 70% of their UK built cars. In 1992, however, the UK withdrew from the Exchange Rate Mechanism (ERM) of the European Monetary System, and does not take part in the singe currency started from 1999. For the last decade, the exchange rate of the pound-sterling fluctuated much more than those days in the ERM until 1992, and this made UK

production and exports more vulnerable and uncertain than otherwise. Since the appreciation of the pound-sterling could reduce the costs of the imported inputs, the import of the parts and components from the Continent can partly offset the loss in the exports caused by the fluctuation of exchange rate, and contribute not to lose the stability of production.[13]

It is also worth to point out that Japanese car MNEs, which led the revival of the UK car production, gradually shifted the source of the parts and components to the Continent (Ando, 2002). The Continental shift was brought by two ways. One of them is that Japanese car MNEs gave the competence to their own Continental plant to supply the parts and components to the UK plants. For example, Spanish plant of Nissan for the commercial vehicle started to supply some components to the UK counterpart from the late 1980's, while Belgium plant of Honda changed from the motorcycle production to the car components one for the UK plant. Another method of Japanese car MNEs to shift the Continental sourcing from the UK is to find out the superior suppliers in the process of accumulating European business experience.[14] An interview at one Japanese car plant said this point as follows;

> Europe is too far from Japan to fully know about the suppliers. However, it is one of the merits obtained from producing cars in the UK that we can recognise the suppliers around Europe. Some of them were not known in Japan at all, but are sufficient capability for our plant. This is one of the reasons to enable us shifting the suppliers to the Continent.

As a result, the UK share of the suppliers' number for Japanese car MNEs went down from 80.8 % in 1989 to 62.7 % in 1996, although the total number increased.[15] It is not clear from these figures how much the UK suppliers contribute to the UK car components export, whereas the increase of the number of the non-UK suppliers directly and certainly leads the increase of the car components import. Therefore, it can be said that the decrease of the share of the UK suppliers has a significant impact on the parts and components trade deficit.

The third element is related with the suppliers themselves. There are some reasons of the UK suppliers not to keep their international competitiveness expressed with the trade balance. The decline of the cars assembled in the UK until the mid-1980's made the suppliers to reconsider their operation. Because of the scale economy, they tended to concentrate the areas with the competitive edge, and retreated from the non-competitive sectors. This is not only for the automotive business, but also for the whole business contents of the suppliers, which produce the other products as well as the car parts and components. As a result, the share of the car components in the total turnover dramatically decreased in some UK main suppliers until the end of the 1980's. For example, Lucas decreased the share of car components in the total turnover from 72 % in 1981 to 59 % in 1991,

while BBA lost the share from 80 % to below 50 % until 1991 (Sadler & Amin, 1995).

Furthermore, Japanese FDI increased the over-capacity of European car industry as a whole, and forced to increase the productivity of each plant. Along with the efforts not only of Japanese, but also other European assemblers' own, they request higher quality and lower price to the suppliers (National Economic Development Office, 1993). In order to fulfil the request, some UK suppliers try hard to improve the productivity including the investment to the Continent, but others could not meet these requests. Indeed, it is often said that Japanese car MNEs would help to improve the UK-based suppliers through closer relationship than under the traditional mass production system, but, that does not mean all of the UK car components suppliers can be beneficiaries. This is because the number of suppliers under the flexible production system is less than under the mass production system, and the second- and third-tier suppliers can receive less assistance than the first-tier suppliers. At the same time, even if the first-tier suppliers could keep their competitiveness, some of them went to the Continent, or sourced the sub-components from the Continent as the same reason with the assemblers in the UK (Trade and Industry Committee, 2001).

Finally, the government element should be mentioned here. The suppliers may well receive less support from the UK government than the assemblers, although some local governments are keen to attract the suppliers' investment along with the assemblers' one (Derbyshire County Council, 1990, Eastwood & Hunt, 1993). There are some reports on the car components suppliers, and they generally insist the importance of suppliers to adopt and adjust themselves to the flexible production system (West Midland Industrial Development Association, 1989, National Economic Development Office, 1993, Lamming, 1994). A report actually requested the active role of the government with the industry organisation to support the suppliers (Lamming, 1994). Some parliamentary committees invited the suppliers including Japanese ones to hear their opinion for strengthening the competitiveness of the UK manufacturing industry (House of Commons, 1993, Employment Committee, 1994). However, still it is fair to say that the interest and support of the government are put on the assemblers more than the suppliers. Less attention for the suppliers is very clear from the volume of the government and parliament reports on them compared with the assemblers. The following quotation from a report on the UK car industry by a consultant represents this point;

> Volume car assembly in the UK may be buttressed by subsidy and by political promises of a stable currency within the Euro but component suppliers do not get the same level of political attention (A. T. Kearney, 2001, p.15).

The combination of the elements above mentioned is attributed to explain the *paradox* of turning the components trade into deficit on the process of the UK car assembly revival.[16] Here, it is noteworthy to mention that the strategy of MNEs is affected by the EU integration, which provides both wider basis to procure the inputs than the member state's economy, and the additional risk brought by the asymmetrical development such as the single currency.

Conclusion

We investigated the FDI and its impact on trade within the regionally integrated economy through the case of Japanese car MNEs. This chapter will give the short summary of the analysis, and discuss the implication for the host country.

The European integration has double effects on Japanese FDI into Europe. Indeed, the more direct competition with the Continent from the 1970's brought by the EU membership of the UK partly contributed to the decline of the UK car industry until the mid-1980's, but Japanese car FDI into the UK would not be realised without the free access to the EU market, as the high export ratio suggests. Furthermore, the growth enhancing effect of the SEM made the FDI more attractive option than otherwise. At the same time, the SEM with the potential threat of a "Fortress Europe" against the outsider such as Japanese car companies facilitated of them to invest into Europe, so as to obtain the status as the internal actor. Japanese FDI has the influence on the international division of labour in the auto and components sector. It is clear that Japanese plant contributed to the revival of the UK car production through the expansion of car exports in the 1990's. However, the parts and components sector did not follow the recovery of the car assembling with the same pace, as the trade balance went down to the deficit from the mid-1980's.

The two *paradoxes* can be derived from our examination of Japanese car FDI in the context of the performance of the UK car industry including the suppliers. The first *paradox* is why the UK venture of Japanese car MNEs succeeded, in spite of the previous failure in Southern Europe, and the unfavourable conditions for the car production in the UK. The answer for this puzzle can be given through the precise investigation of the three advantages of Dunning's eclectic paradigm. The flexible production system, which is the basis of the ownership advantage, can be transplanted through the appropriate internalisation method, i.e. the greenfield investment, which modified the unfavourable conditions in the UK to more appropriate ones for Japanese car manufacturing. At the same time, the UK offered a series of the locational advantages. Among them, English as the close communication tool, and the availability of the middle managers with the industry experience have

special importance for the transfer of the flexible production system. The UK provided these three advantages for Japanese car FDI simultaneously, and that is the reason of success. This further directly and indirectly related with the second *paradox*.

The second *paradox* is why the suppliers in the UK could not maintain the trade surplus, which had formerly been kept even in the days of deterioration of UK car manufacturing, in the process of the car production revival. This is the result of combining various elements. The assemblers took the appropriate procurement policy to transplant the flexible production system under the condition of the local contents, but that did not always achieve the results expected by the local economy. The exchange rate volatility, especially after the UK departure from the ERM, led the UK based assemblers to source more from the Continent than otherwise. Some suppliers in the UK could not meet the requirements of assembler in terms of the price and quality, while others tried to move to the Continent or to source the sub-components from the Continent. The insufficient government policy should be also pointed out.

The analysis in this paper above summarised includes some policy implications for the FDI host country within the integrated area. First, utilising the inward FDI for the purpose of revitalising the domestic industry is likely to be more successful on the basis of the regional economic integration than otherwise. Under the EU integration, any member state can enjoy the benefit brought by larger market than the domestic one, and that gives the additional location advantage for the FDI, which may well improve the invested sector and the host economy through transferring the intangible assets of the MNE in question. On the other hand, the integrated area provides the basis for the procurement by MNEs of the necessary inputs, and this means the effect of FDI on the local economy through the sourcing of the material, parts and components could be partly eroded to other member states. Thus, the EU integration has the double-edge meanings for the host country. The impact of FDI on the trade within the integrated region should be assessed not only from the export side, but also from the import one, although the previous works tend to look at the former one. The analysis here explicitly considered the previously missed aspect of the influence of FDI on the trade in the regionally integrated area. Third, the commitment of the host country to the EU integration further affects not only on the inward FDI, but also the existing MNEs' operation, as the non membership of the UK to the ERM and the single currency forced car MNEs to procure the parts and components from the Continent more than otherwise.

[1] There are a lot of works on Japanese car FDI into Europe. On the cases of the UK, see, for example,

Hudson (1995), Dicken (1987), Sachwald (1995), Ando (1997).

[2] The description on Japanese car FDI into the UK is based on the materials provided from the plants themselves to this author directly at the interviews, or by post.

[3] Most of the literature above mentioned in F.N. assume the success of Japanese car FDI into the UK, and consider the impacts on the UK car industry. Much less attention are paid to the possibility of the failure.

[4] Indeed, SMMT provide the categorised components trade statistics, but the largest branch is "other parts and accessories", which shares nearly half of the grand total.

[5] On the detail of this section's analysis, see Ando, K. (2002).

[6] This point is insisted at the interview with Nissan by this present author.

[7] In actually, Honda was asked to acquire the Rover group by British Aerospace itself, but answered to buy up to 50 % of the share, rather than the full ownership. The information is from the interview at the parent headquarter of Honda in Tokyo, Japan.

[8] Plentiful works suggest the importance of the workers relationships in Japanese car plants, especially in Nissan plant, although their normative assessments are different from each other. See, for example, Wickens (1987), Garrahan & Stewart (1992), Rehder & Thompson (1994). However, very little research gives attention to the importance of the middle and upper managers.

[9] This point was confirmed at the interview with some trade unionists in the UK.

[10] The relationship between management and labour had been a serious issue not only for the car industry, but also for the manufacturing industry as a whole. The interview by this present author with the trade unions in the UK emphasised that Japanese FDI including those for the car industry contributes to improve the relationships very much.

[11] Motor Industry Local Authority Network (MILAN) reports the transforming situations of the plant operation in the UK. MILAN (1995a, 1995b, 1996a, 1996b)

[12] This present author has already pointed out this paradox, although the analysis was not given there. See, Ando (1997).

[13] Diversifying the plants as the risk management was already used by American car MNEs in the 1970's. Now, the parts and components sourcing policy is added to such a risk management. On the plants diversification as the risk management, see Maxcy (1981).

[14] The Internationalisation Process Model points out the importance of the knowledge accumulation through the foreign operation. See, Johanson & Wiedersheim-Paul (1975), Johanson & Vahlne (1977).

[15] In 1989, Nissan was the only one Japanese car MNE assembling cars in the UK, and procured from 97 UK based suppliers among the total 120 suppliers. In 1996, three Japanese car MNEs committed the full line assembly, and procured from 384 UK suppliers among the total 613 suppliers. The data is from the company, and the local governments, in whose area Japanese car plants are located.

[16] Here, our analysis is mainly based on Japanese car MNEs, though with some support from the other cases such as US car MNEs in the UK. However, since the parts procurement practice is the most similar between Japanese and other plants in the UK among the six groups of production system according to Abo's field research (Abo, 2001), we may expect Japanese cases can be the appropriate sample for our theme.

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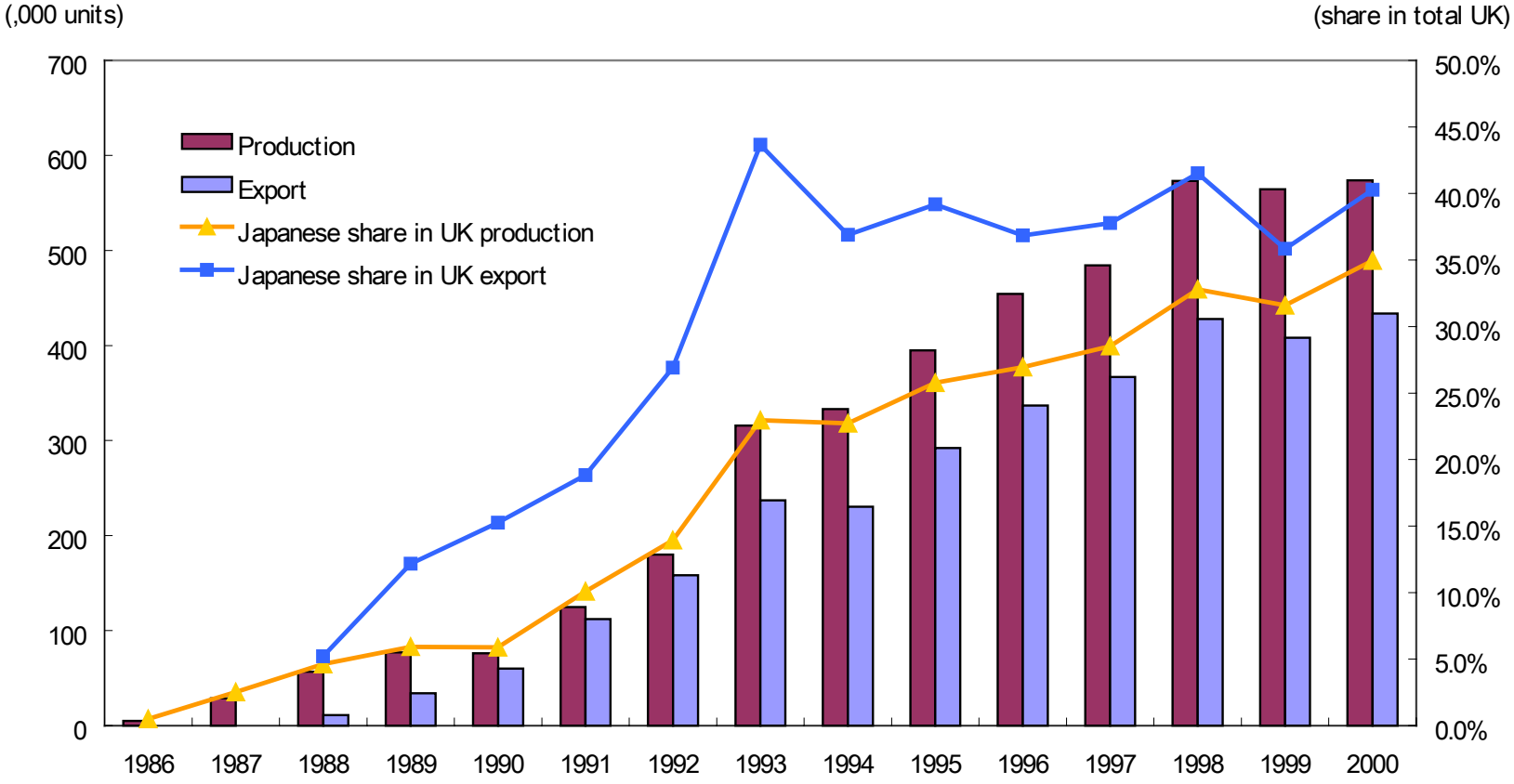
Table & Graphs

Table-1 Chronology of Japanese Car Plants in the UK.

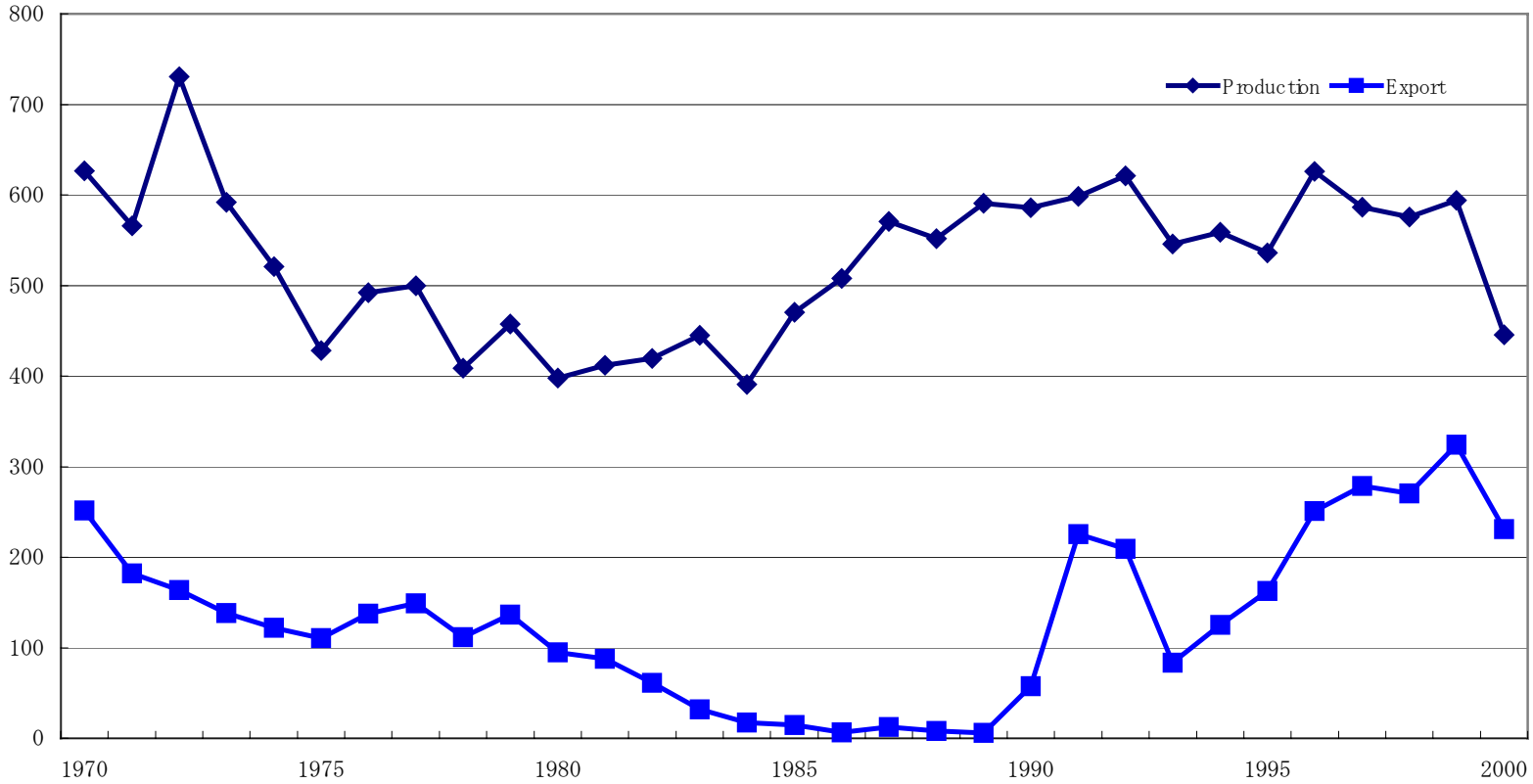
	Nissan	Honda	Toyota
1979		Partnership with British Leyland (lately, Rover group)	
1986	Knockdown production of large size model in Sunderland plant	Pre-delivery inspection of Honda cars produced by Rover in Swindon plant	
1987	Full line assembling of large size model		
1988	Exports from Sunderland plant		
1989		Engine production	
1992	Second model (small size)	Large size model production and export	Large size model production in Burnaston plant
1993			Export from Burnaston plant
1994		Second model (medium size)	
1998			Second model (medium size)
2000	Third model (medium size)	Third model (SUV, maintaining the capacity)	
2001			Second full line plant in Europe starting production (Valenciennes)

Graph-1 UK Car Production and Export by Japanese MNEs



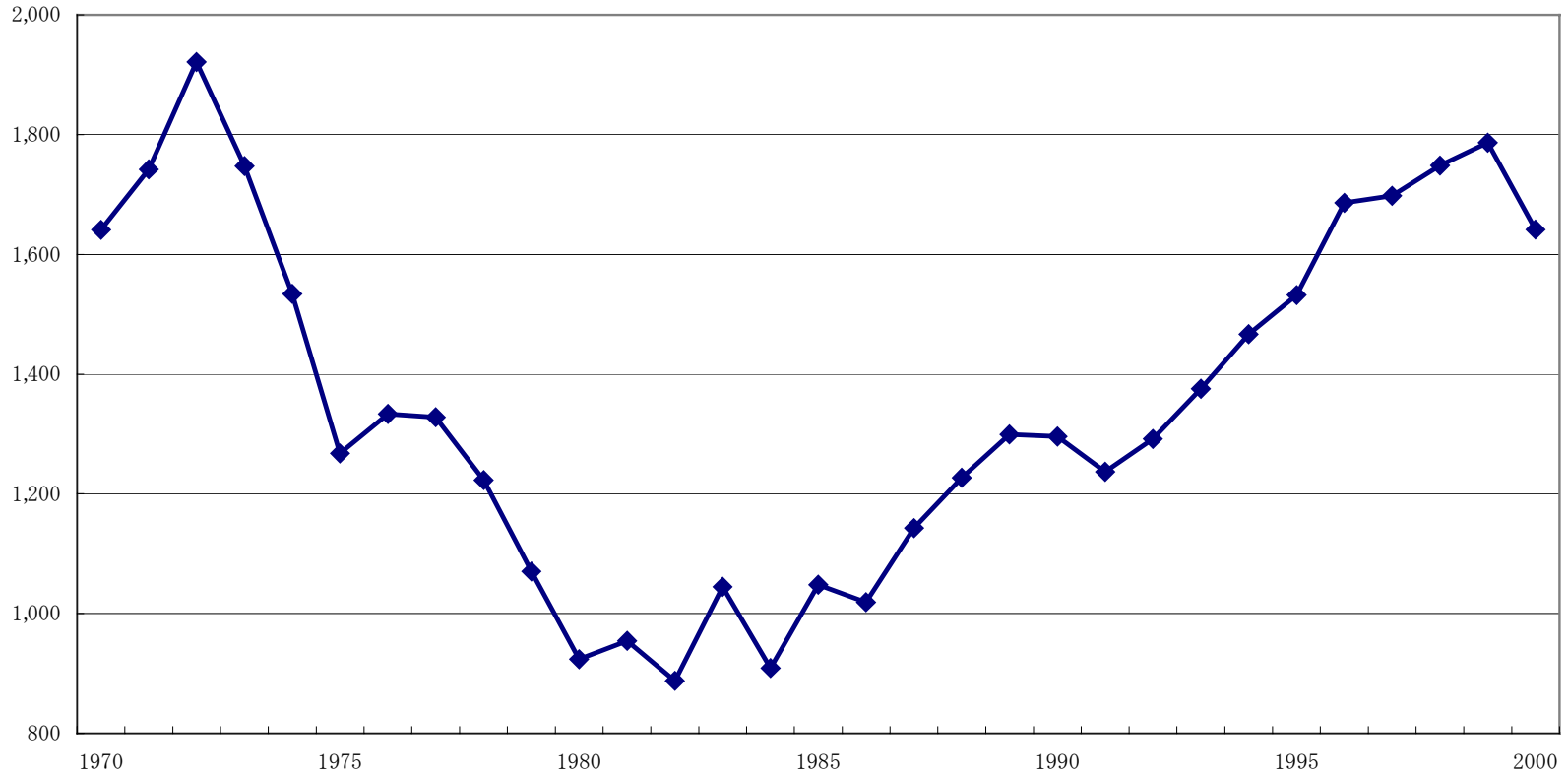
Source: SMMT, various issues.

Graph-2 US MNEs Car Production & Export in the UK (,000 units)



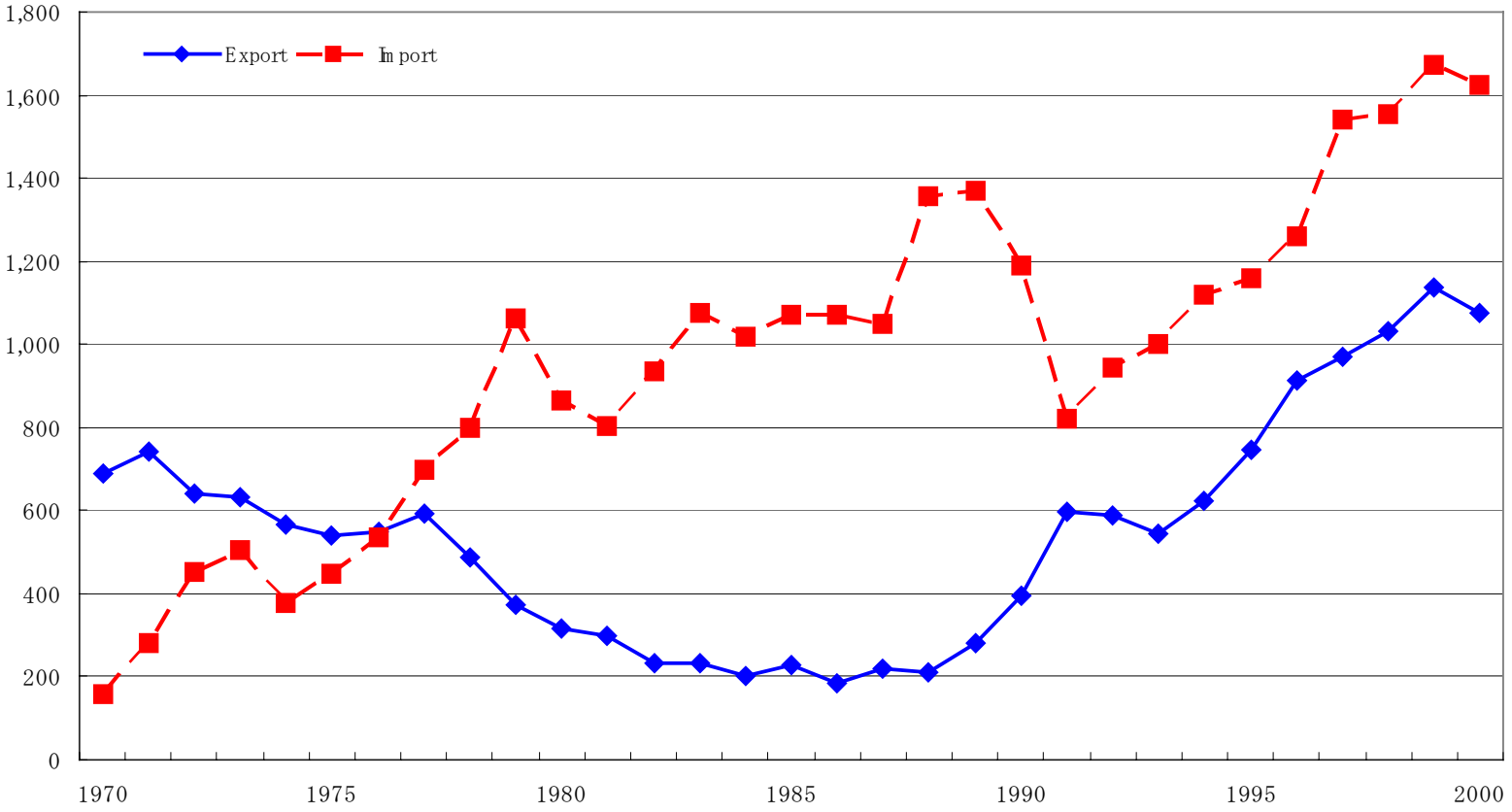
Source: SMMT, various issues.

Graph-3 UK Car Production (,000 units)



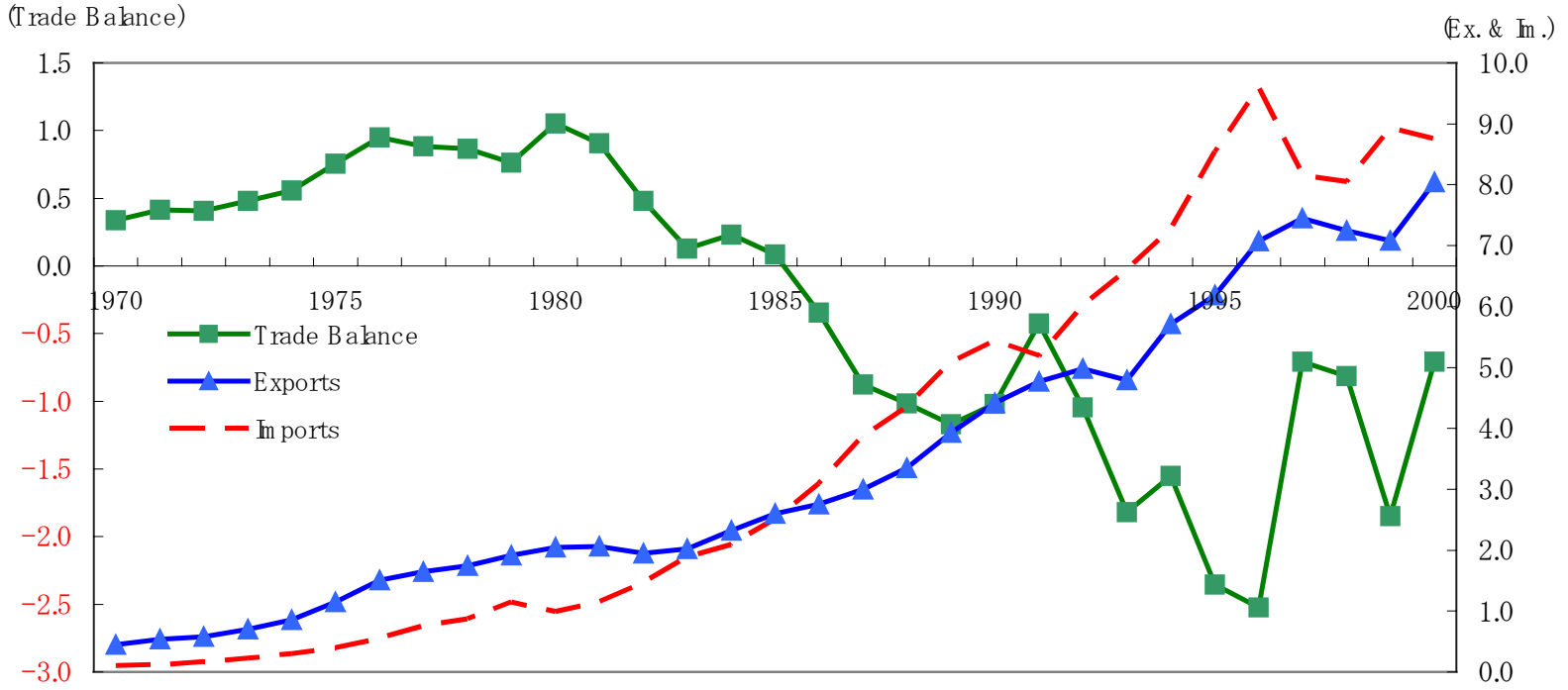
Source: SMMT, various issues.

Graph-4 UK Passenger Car Trade (,000 units)



Source: SMMT, various issues.

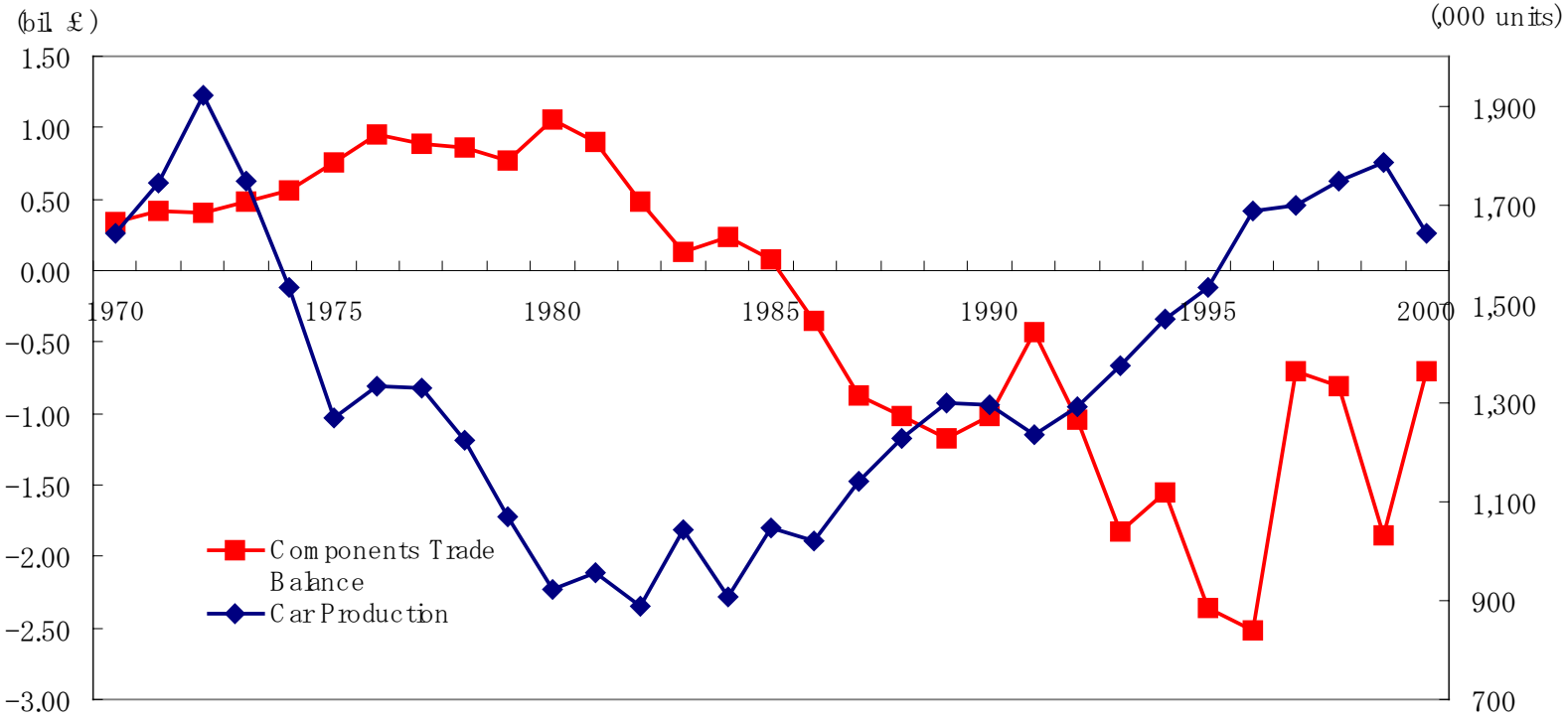
Graph-5 UK Components (*) Trade (bil £)



Source: SMMT, various issues.

* includes followings: rubber tyres, fan belts, brake & clutch lining, engines, safety glass, locks, apparatus to make circuits, accumulators, lamps, starter motors, sparking plugs, electrical equipment, radios and tape players, seats & parts, bodies, gear boxes, axles, brake and parts, shock absorbers, wheels and parts, radiators, other parts and components

Graph-6 UK Car Production and Components (*) Trade (,000 units, bil. £)



Source: SMMT, various issues.

* includes followings: rubber tyres, fan belts, brake & clutch lining, engines, safety glass, locks, apparatus to make circuits, accumulators, lamps, starter motors, sparking plugs, electrical equipment, radios and tape players, seats & parts, bodies, gear boxes, axles, brake and parts, shock absorbers, wheels and parts, radiators, other parts and components.