

# **The effects of international relocalisation. A system approach to the “made in Italy” sector analysis.**

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## *1 Introduction*

This paper presents the results of a study on the international re-localisation of production, a phenomenon labelled in the current debate as “international fragmentation of production” (Arndt, 1997; Jones, Kierskowski, 1997, 2000). More in particular, research activities have focussed on the processes through which firms based in a given country re-locate lines or phases of production abroad.

These processes are becoming more and more important across all industrialised countries. Since the beginning of 90’s such a pattern of internationalisation is becoming to spread also in some sectors of the Italian productive system. The aim of this paper is to analyse the characteristics of these processes in the case of Italy and draw some implications regarding the theory and conceptualisation of internationalisation.

Our analysis starts from two hypothesis:

- The increasing fragmentation of production at an international scale highlights the caveats of economic theory in the analysis of current processes of internationalisation of production;
- The “made in Italy” sector represents a particularly interesting case to look at. This is because of the increasing importance over the last decade of “re-localization strategies” in this sector, but even more, because firms which adopt such strategies are in most cases part of well integrated local production systems.

As far as the first hypothesis is concerned, the thesis argued in this paper is that the theory of internationalisation, both in terms of trade or multinationals’ behaviours (that has been traditionally a “theory of the determinants”) do not fully allow us to deal with international relocalisation. As far as the second hypothesis, the presence of local productive systems makes the limits of the traditional approach to internationalisation more neat. The latter is in fact very much focused on the characteristics and behaviour of firms rather than “systems”, and, as such, is not sufficient to analyse internationalisation processes which are the results also of (and at the same time have an impact on) the characteristics, functioning and performances of a plurality of firms and interactions.

The empirical analysis contained in this paper is based on the use of both firm level data (even if the focus is only on the Regione Veneto) and data referring to local systems. It adopts both a short-term perspective through the use of data on employment and skills (par.3) and more long term view with an analysis of data on productivity and innovation. (par. 4).

## *2. Some considerations on the theory of multinationalisation*

During the 90s the literature regarding the processes of internationalisation of production has been enriched by a number of considerations regarding the role of contextual elements in firms' choices for international growth. In particular, the meaning of localisation advantage has been expanded on the one hand, and, on the other hand, more importance has been given to the analysis of networks of firms, as an explanation of the types of international involvement that have developed.

The expansion of the meaning of localisation advantage has consisted essentially in the fact that, while in earlier approaches the localisation advantage was used to indicate the geographical destination that could best leverage a firm's ownership advantages, in the new approach the localisation choice is seen also as an expression of more complex strategies and, in particular, as a way to create or consolidate ownership advantages. A firm's decision to invest in a determined area has been linked to the existence in that area, for whatever reason, of advantages that the company intended to acquire. The decision to establish a presence in a given area, under this approach, could thus be explained in terms of the intention to learn from contexts that generate learning resources.

The analytical flaw in this type of analysis does not lie so much in the expansion of the meaning of localisation advantage, as in the fact that the advantage can only be defined within the sphere of the interactions that characterize a specific geographical context. The advantages acquired through investment are not *una tantum*, rather they tend to increase constantly.

By analogy, once the meaning of localisation advantage is thus expanded, a similar approach becomes logically reasonable in the analysis of proprietary advantages. In a similar manner, ownership advantages may not be an acquired fact but may be acquired from the context through the interaction with it. In short, it can be argued that a company can decide to do an FDI without having a definite ownership advantage. What is important is that the company becomes part of a context of relationships capable of creating the

conditions for the emergence of such an advantage, a context that adapts itself and becomes consolidated in time.

The second aspect of the developments in the theory of international production that should be highlighted is the greater attention paid to networks. It is a matter of great relevance from a logical point of view, as can also be seen from the literature. In the past Dunning (1997) had already highlighted that the existence of networks of companies had an impact on the choices of the individual companies. Pushing these considerations to their limit, Cowling and Sugden (1987, 1998) considered the partnership relationships created by a company with the external world as part of the company itself. Letto Gillis (2002) speaks of network firms and, above all, of the fuzzy boundaries of the firm; boundaries that are uncertain not only insofar as localisation is concerned, but also with respect to the organization and, in particular, control. In other words, the author suggests that, where networks are to be found, the juridical unit does not coincide with the economic unit at all three levels.

Let's delve into this question. Normally, in the literature, juridical control and total control coincide. Strictly speaking, there have been authors, particularly in the second half of the 70s and the first half of the 80s, who are clearly aware that this type of choice implies an approximation, and that this approximation has a sense because it allows for a more efficient identification of the phenomenon, that is an identification that enables the measurement of said phenomenon. The idea of a coincidence between control and juridical control has been strengthened by the development of the internalisation approach, with the adoption of an interpretation key that explicitly referred to the different types of juridical relationships established among the parts as a consequence of economic choices. On the other hand, the fact that the subjects of international production were substantially large or very large firms made the problem relevant more at a logical level than at the level of measurement. Juridical control, in other words, could be considered until not very long ago a good *proxy* for total control.

In a context of developing networks, where the fragmentation of production tends to become a new form of production organisation, such an approach loses validity. In order to make the concept of control consistent with the so called "fuzzy" boundaries of a firm, Letto Gillies (2002) refers to operating control on one hand, and strategic control on the other. The issue is that, if a more complex idea of control is used, thus abandoning the juridical reference, yet again not only does the very definition of international production become debatable, but the theoretical references become less solid. The fact that side by side with

the visible multinational activity there is a parallel activity that goes unseen because control is not of a juridical nature is self-evident. Less evident, but equally intuitive, is why the use of a wider control notion poses problems of theory. Given that it is possible to establish a control relationship that may not be of a juridical nature, under this approach we could consider as international production also other international operations such as agreements and, in some cases, trade. In other words, the theory of internationalisation is no longer able to discriminate between what constitutes international production and what does not. The focus of theory must necessarily move from the juridical nature of the individual transaction to the substance behind the operation itself.

In order to make a choice between different forms of internationalisation, a firm must be able to evaluate the alternatives. It must be able to measure them. But how can the value of alternatives be measured when the very boundaries of the firm are uncertain? And even in the case that this measurement may be performed, does it make sense to reason in terms of choice in a static context, when companies are so intertwined that the interdependencies of the various decisions made by the vast number of subjects composing a network are the ones that create or transform the competitive advantages? In other words, they are that which determines and therefore defines the existence of competitive advantages.

In addition, the distinction among forms of internationalisation makes sense when, through these choices, it is possible to identify different *rationales* for international growth. When a firm's choice of a given form of internationalisation can be understood and explained only within the sphere of what is being done by the other subjects participating in the network itself, this type of approach can only lose relevance. A collaboration agreement with foreign partners acquires a different meaning if included in a context (intended both as area of origin and area of destination) in which either IDE or trade prevails. When there is a strong network component, i.e. when, to simplify, it can be said that the networks are being internationalised, we need to look to the entire set of operations in order to understand the logic underpinning the processes at work. In short, if we accept the existence of definite system advantages as assumed above, the bond between the choosing subject and the choice itself, understood as the pursuit of a specific strategy, becomes much weaker.

The author is convinced that all of the above becomes all the more relevant when we take into account something that is more easily definable than networks – at least at geographical level - , i.e. the local systems. By local production systems we mean local

realities characterized by a strong sectoral specialization and by the presence of substantial external factors, but where alongside the group of networked companies we find in operation various private or public institutions.

To summarize, the application of the current theory of multinationalisation to a district, to a system, and therefore to a set of diverse companies and institutions becomes unsatisfactory because, observing the company from too short a distance, we only obtain part of the story. The problem lies in that the part of the story we do see is not representative of the entire story. The meaning of what is visible can only be comprehended within the context of a bigger story. It is quite evident, in fact, that the part of the story we do see is influenced by the part we do not see.

Obviously, this does not mean that to look at what happens inside a company becomes irrelevant in order to understand the impact of the processes of production internationalisation on the systems involved. On the contrary, it means that in order to reach this objective, it is necessary to compare the information that can be gathered from the firm's data with data resulting from a study involving the entire context within which such processes take place.

### *3. The effects on the Italian production system*

The effects of internationalisation of production have been discussed in the second section where we have pointed out that most of the indications stem more from the theory of international trade than from the one dealing with international production (Feenstra, Hansen, 1995, 1997; Feenstra 1998). A more in depth discussion of this point is contained in a previous contribution by the author<sup>1</sup>. In this paper we are interested in examining another proposition put forward by several scholars in the field and identified as one possible converging conclusion of the debate at least concerning the impact of the processes of international integration on firms (Krugman, 1994; Berman, Bound, Griliches, 1994; Lawrence, 1994). According to this approach the increasing specialization of advanced countries in hi-tech products, and the parallel shift of traditional production activities in low-wage countries has displaced in some countries less qualified jobs which

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<sup>1</sup> The methodological approach to the analysis of the "*made in Italy*" sector is contained in, "La delocalizzazione internazionale: problemi di definizione e di misurazione. Un'analisi per il settore del "made in Italy", in *Economia e Politica industriale*, anno XXVI, n° 103, 1999. A more recent contribution is contained in R. Schiattarella, "International Relocalisation and Employment: an Analysis for the Traditional Italian Industries", in R. F. Pizzuti, M. Franzini, (eds.), "Globalization, Institutions and Social Cohesion", Springer, 2000.

in turn has been the main reason for the heavy job losses and lowering of wages of such component of the labour force.

As pointed out in our previous contribution this conclusion is not convincing, not only because the pattern described above was not found in all countries but also because of the approach chosen to tackle the issues and namely the one based on the theory of international trade which cannot be applied to all kind of countries. Our hypothesis shown in the second section is that in some cases (such as those examined in this paper) where the systems rather than firms are those which get internationalised, international trade flows as well as international agreements could tend to develop interlinked with direct investments according to a "international production" rather than an "international trade" logic.

Our attempt consists, therefore, of collect data and interpret the results with this different perspective. For this purpose we have distinguished between three groups of regions (and in some cases even provinces). The first group of regions includes the areas showing the highest rate of relocalisation, that is regions (or provinces) where the ratio between the "relocalisation share" (on the Italian aggregate) and the "employment share" (again on the Italian aggregate) was above 1 in 1998. The second group includes the regions (or provinces) where the same index varies between 0.5 and 1. The third group includes the remaining regions (or provinces).

Table 1

**The effects of relocalisation on exports and employment, 1990-1997**

Made in Italy sector

1990 = 100

	exports (province)		employment (regions)
	prices	quantity	
group 1	335	324	93.9
group 2	186	165	90.9
group 3	94	74	90.4
cograduation index (provinces)			0.21

source: elaborations on ISTAT and INPS data

A first answer to the question regarding the "effects" can be given looking at Table 1 which shows, for the three different groups of regions, the evolution of competitiveness measured by exports in values and quantities between 1990 and 1998. The result are very interesting and surprisingly clear-cut. It clearly emerges that the Italian provinces where the relocalisation process has been more substantial are those which show the best export

performances. Differences between the three regional groups are particularly significant. In the case of the first group exports have increased more than three times in value, while they have almost doubled in the second group and slightly decreased in the third one.

Obviously, this result can be explained by the fact that international relocalisation has emerged as a successful strategy. Firms which have relocalised the most are those which have become more competitive and shown the best international performances. However it is equally reasonable a different, or even opposite, explanation based on the argument that firms which delocalise are the most successful firms. According to the latter hypothesis, relocalisation is more an effect than a determinant of performance. A comparison of data in values and quantities allows us to start clear the matter. Prices of products exported by firms located in the first group of provinces have, in the eight years period considered, grown less than those of the second group (3.5% compared to 12.6%) e much less than those in the third group (26.0%)<sup>2</sup>. In other words, one of the factor explaining the better performances of the areas which show a higher delocalisation rate resides in the capacity of firms to contain prices. This result is not a surprise since relocalisation of production is carried out in order to reduce costs and adopt more aggressive price strategies on the international markets.

The areas where a higher propensity to relocalise have experienced an overall better performance. This also allows us to interpret the employment trends showed in Table 1.

Despite part of the literature suggests the opposite, international relocalisation does not seem to have had a negative impact on the employment. The job-loss effect, which is traditionally attached to the international movements of phases of the production process (as well as of products), seems to have been counterbalanced by the better performance occurred in these areas. The empirical evidence shows an overall negative employment performance. Nevertheless, the job-losses have been less dramatic in the areas with a higher propensity to international relocalisation. The Spearman co-graduation index between the level of import per employee by province, related to the re-localisation, and the employment change occurred within the same sector, shows that, if any correlation is found, it is a positive one. Areas with higher dimensions of international relocalisation experience a better employment performance.

For a better understanding of this results, we have carried out a survey in Veneto, on 90 firms, which have somehow relocalised their activities during the previous three

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<sup>2</sup> It should be pointed out that export growth can only to a limited extent be explained by the growth of

years. The survey has dealt with the issue of the economic impact of international relocation. A control sample of 30 firms not involved in relocation processes has also been interviewed. The dimension of the relocation activities carried out by the 90 firms surveyed represents the 40% of the total relocation activities carried out in the whole region. Firms have been asked to evaluate the impact of their localisation activities on the employment (Table 2).

Table 2

**The effects of relocation on firm employment**

Made in Italy sector

percentages

	growth	no effects	decrease
firms number	20.9	63.7	15.4
employment	21.5	57.0	21.5

source: elaborations on DSD – Coses data

Most of the firms (63,7%) have answered that the relocation activities have been neutral as far as the employment impact is concerned. 21% of the firms state that a positive impact on employment occurred, whereas the 15% have found a negative impact. When the size of the firms in terms of number of employees is taken into account, the positive impact on employment results offset by the negative impact (21, 5%). 57% of the surveyed firms declared a neutral effect on the employment.

The most interesting results emerge when we look at the change in the composition of the employment. The first column in Table 1 shows that a correlation between the change in the composition of employment and the relocation intensity can be found. In the first group of areas, a major shift from the workers to the clerical activities is found. The third group of provinces such a shift has been relatively smaller. As we could expect, international relocation has a major skill bias impact, which tends to displace less qualified jobs and increase jobs with a higher level of qualification. This phenomenon could better qualify the previous results: the areas with a higher propensity to relocate show a better overall employment performance (probably due to the skill-bias effect). The second column in Table 3 shows the wage differentials by different groups. The results are consistent with our interpretation. The first group of provinces shows a wider wage differential. This seems to suggest that relocation activities have had a significant impact also within the clerical job-category itself. Two variables influence the wage



differentials. If relocalisation activities displace de-skilled jobs, the wage differential should narrow down. The first group experiences a widening of the wage differential: this might suggest that the positive impact on the skilled jobs more than offsets the wage growth of workers.

Table 3

**The effects of relocalisation on employment composition and wage differentials between non manual and manual workers, 1997**

Made in Italy sector

1990 = 100

	non manual/total employment	non manual/manual workers wage
group 1	120.0	107.0
group 2	114.1	97.2
group 3	111.8	100.7

source: elaborations on INPS data

Again, for a better understanding of this results, we asked to the firms to evaluate the impact of their localisation activities on the employment composition (Table 4). More than 40% of the firms interviewed answered that a change in the internal organisation occurred. When we consider firms which have signed AC or carried out IDE, this figure jumps at 75%. This suggests that radical changes in the organisational features of the firm occur when the link between the Italian and the foreign firm becomes more stable.

Table 4

**Firms organisational structure changes**

Made in Italy sector

percentages

	org. changes	new prof. creation	transfers	at least one change
Agreements	40.6	43.5	33.3	76.1
IDE	75.0	75.0	75.0	100.0
Both	36.8	84.2	42.1	94.7
relocalising firms	41.3	53.3	37.0	76.1

source: elaborations on DSD – Coses data

The empirical evidence does not support a particular link between the size of the firms and the number of reorganisation activities carried out. This suggests in turn that a correlation between production reorganisation activities and international relocalisation does exist.

Table 5

**The effects of relocation on firm employment**

Made in Italy sector

	growth	no effect	decrease
managers	11.3	82.5	6.3
employee, middle ranking man.	25.6	69.5	4.9
qualified manual workers	29.3	61.0	9.8
non qualified manual workers	6.2	75.3	18.5
total	20.9	63.7	15.4

source: elaborations on DSD – Coses data

Overall, as expected, organisational changes have mostly involved high skilled jobs (Table 5). Among these, we find not only clerical, but also specialised workers. The strongest negative impact regards low skilled workers.

*4. Long-term effects*

The analysis carried out so far draws an optimistic picture as far as the impact of international relocation on employment is concerned. It should be recalled that such picture mostly refers to the short run impact.

Table 6

**The effects on Italian system, per-capita investment and labour productivity**

Made in Italy sector

	investment*	labour productivity	
		1980-89	1990-96
group 1	-13.6	25.6	24.3
group 2	-6.1	33.1	23.4
group 3	+64.3	27.3	13.7

\* average 1997-94/ average 1988-90

source: elaborations on ISTAT and INPS data

An analysis of the long run impact of relocation on employment should take into account further variables, such as the level of investments, of productivity and innovation activities. We shall try to analyse these variables both from a firm and a systemic perspective.

Table 6 presents the change of the level of investments (comparing the average 1997-94 and the 1988-90) for the three groups of regions, as well as the change of productivity over the period 1990-97.

The results presented in Table 6 show that the areas, which have most relocated have also experienced a strong decrease of the level of investments. It seems therefore that international relocation strategy is substitutive with respect to strategies of expansion on the domestic market. Further, when an increase of the level of investment per employees occurs, we see that international relocation has not been particularly relevant. Table 7 reports the results of the effects of relocation on investments.

Table 7

**Firms investment**

Made in Italy sector  
percentages

	relocalising firms	AC	IDE	both	non relocalising
firms					
made investment	88.0	87.0	75.0	94.7	78.6
in					
production growth	44.6	40.6	57.9	50.0	72.1
labour saving	22.8	17.4	31.6	75.0	10.7
innovation	68.5	65.2	78.9	75.0	64.3
foreign production	26.1	20.3	47.4	25.0	-----

source: elaborations on DSD – Coses data

Regarding the investment done in 1995-97 in order to acquire machinery and equipment, high percentages emerge both for relocalising firms (less than 90%) and for the non relocalising ones. The motivations analysis point out that the investment is clearly connected to the technological innovation (82% for the relocalising firms, 72% for the others); the investment aimed to increase the level of production characterises the non relocalising firms enterprises (72%), regarding the ones that do it (47%). However, if we sum the investment finalised to the foreign production (27% for the relocalising firms and equal to 0 for the others), quota become similar (72-74%). This result suggests that the relocation can effectively have a negative impact on the investment level inside the country.

It is worth to notice that a number of firms (little more than 20) carries out investments in machines and equipment in order to produce in the foreign country even if the relationship with the foreign firm is not apparently tightening (these firms are connected

with AC). Clearly, the purchase to the foreign firm of the machinery, with which the production must be carried out, establishes a relationship of fact control. This result testifies the complexity of the relationships in these processes.

Beyond this last consideration, however, the picture that has been delineated seems to indicate that the international relocation produces a strong increase in the competitiveness through policy of lowering prices rather than qualitative improvement of the production processes.

The labour productivity data do not confirm this picture (second part of Table 6). It is easy to observe that the productivity trends, in the 80's, do not seem to express some appearing logic. In the 90's, on the contrary, the indications are extremely clear. It clearly emerges that the regions where the relocation process has been more substantial are those which show the best productivity performances. Differences between the regional groups are significant especially if we consider this result is obtained using the same price index for all the groups of regions. If we assume – reasonably considering export data (table 1) - that the prices grow less in the regions in which more consistent relocating processes occur, the differences between the productivity trends could be strongly emphasised.

Table 8

**Firms innovation activity**

Made in Italy sector  
percentages

	% innovative firms	% product innovations	% process innovations
Relocalising firms	80,4	52,2	64,1
AC	76,8	49,3	60,9
IDE	75,0	25,0	75,0
both	94,7	68,4	73,7

source: elaborations on DSD – Coses data

How is it possible to explain these trends? Clearly, the relocation processes have fostered the reorganisation of the production and therefore the productivity increases; but it cannot be excluded that where the faster innovation processes are, the easier is to relocate the phases with a low content of knowledge.

In order to answer to this question, we have interviewed relocating firms. The propensity to innovate is rather high (Table 8): approximately 80%, in fact, has introduced,

in the period 1995-97, at least a product and/or a process innovation of, while the same value related to non relocating firms is equal to 61%.

The innovations processes clearly prevail, realised approximately by 64% of the relocating firms, (last column of the table), while product innovations are realised by more than half of the firms. If we examine the results in details (Table 9), it is interesting to notice that, as to the relocating firms, surprisingly, the size does not seem to have any role in determining the propensity to innovate: all the firms with more than 100 employees has at least introduced an innovation, but differences in the propensity to innovate are not significant and the propensity is higher in the micro-firms (< 20 employees) than in the intermediate class (between 20 and 100).

Table 9

**Firms innovation activity, by sector and by size**

Made in Italy sector  
percentages

	% innovative firms	% product innovations	% process innovations
textile-clothing	71,4	40,8	57,1
footwear and leather	90,7	65,1	72,1
up to 10 employees	78,6	42,9	57,1
11-20 employee	84,6	46,2	69,2
21-50 employees	73,7	47,4	47,4
51-100 employees	70,4	48,1	59,3
over 100 employees	100,0	70,6	88,2
non relocating firms	60,7	35,7	46,4

source: elaborations on DSD – Coses data

At a sector level we can notice some differences in the innovation rates that are greater in footwear sector (90,7%) regarding that one of textile clothing (71,4%): moreover, in the footwear sector approximately 46% of the firms has introduced both process and product innovations. The percentage comes down to approximately a quarter for the other sector.

In conclusion, an important result emerges from this analysis. The relocating firms innovate a lot and their international dimension seems to play a role on their capacity to innovate. The propensity to innovate for the non relocating firms is as well rather high. If we consider the survey on innovation in the same region and for same sectors (made by ISTAT) referred to 1990-92, the percentage of innovative firms is 14%.

Therefore the innovation rate of the system has grown a lot in the 90's, as it is

confirmed from the preliminary data of successive surveying (ISTAT). Obviously, the empirical evidence is not sufficient in order to establish how international relocation affects innovation. However it offers a meaningful support to the idea that the productive internationalisation of the system connected with relocation can be explained by saving costs strategies, but it implies, and perhaps favours, also significant improvements in terms of efficiency of the production processes.

## 5. Conclusions

The analysis carried out in this paper originated from some theoretical considerations.

For an effective analysis of the processes of international relocation of production a re-thinking of the analytical tools is required.

In all cases in which it is reasonable to expect that firms relocating production activities abroad exert some form of “control” on such activities, approaches which read such processes using the standard “international trade theory” or even the consolidated theory of Multinationals become less effective. This in turn raises the critical issue concerning what “international production” is (and what it is not) and, consequently, how it should be measured.

If the international relocation of production has to be conceptualised and interpreted as one broad phenomenon, then the analytical distinction between FDI, AC and international trade becomes less important.

As far as the effects of the processes of international relocation on employment, the analysis presented in this paper has allowed us to distinguish between short and long period effects. In the short period we have found a non negative impact and in the specific case of the *made in Italy* sector we found a positive effect. But our most interesting result is that relocation leads to strong changes in the composition of employment. The qualified labour increases to the expenses of the less qualified jobs.

In the short period, the reorganisation of production at an international scale has a positive effect on the competitiveness of the firms and areas involved in these processes, first of all for a “price” effect. In other words, the international relocation of production is a strategy which allows firms to reduce costs giving them an international competitive advantage based on “prices”. Such enhanced competitiveness on the cost/price side is likely to explain the good employment performances experienced by some specific Italian regions and local production systems.

The assessment of the long term effects of the international relocation of production is much more problematic. Our research has in fact shown the presence of a certain degree of substitutability between investments made inside the country and those directed to the setting up of production capacity outside Italy. Despite the presence of such “substitution effect” the deep processes of reorganisation of production brought about by the overall process of relocation seemed to have had a positive effect on labour productivity. Furthermore such organisational changes have gone hand in hand with an increased innovative capacity of firms and production systems involved in such processes of relocation of production. All in all these processes of relocation of production have therefore worked as main driving forces of industrial growth and major long term catalyst factors for long term economic growth. In other words, the view of international relocation of production pushed by cost and labour saving determinants seems at the same time an over-simplified picture of the overall process and does not seem to be supported by our empirical evidence.

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