"A Survey of the Organization for Economic Cooperation and Development's discussions regarding the '*hollowing out*' of the manufacturing industry in the U.S., Europe and Japan in the 1990's."

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Introduction

Despite the economic downturn due to the collapse of the bubble economy, foreign direct investment in Japan has steadily continued to increase. In addition, importation of assembled products has increased rapidly, peaking in 1995 with 198.5 billion dollars worth of imported goods. This represents a 30.9% increase from the previous year. In spite of the slumping domestic economy not only have imports increased rapidly, but also Japanese capital investment abroad has increased as well. This flow of investment, technology and employment out of Japan has recently received ample media coverage and is referred to as the *hollowing out* of the Japanese economy. The hollowing out of an economy is a concern to all advanced nations and is a reflection of the current trend of *globalisation* that was addressed for the first time in the economic summit held in Lyon, France in June of 1996. At the summit, a declaration was agreed upon recognizing that globalisation of the economy will offer positive contributions to the global economy. However, at the summit there was a major concern that jobs in advanced industrial nations may be negatively affected due to the intensification of competition by dynamic new economic blocks. As a result of this, the industries that are skilled-labor-intensive would expand in advanced countries and industries that are unskilled-labor-intensive would decrease correspondingly. Therefore, wages for skilled workers will increase while that of unskilled workers will decrease in advanced countries and when seen as a whole, trade can be a potential factor in the expansion of the disparity in wages.

In this light, Krugmann showed the possibility that the expansion of trade with developing countries will cause the expansion of wage disparity in advanced countries by changing the industrial structure. In line with this, it is stated that in the case of the U. S., though the share of developing countries is increasing, main trading partners are advanced countries that have wage standards that are approximately the same as that of the U. S. and it is highly unlikely that it has an influence on the U. S.'s wage standard.

Leamer (1993), who also thinks expansion of imports is a factor of income disparity, is basically arguing his theory based on factor price unemployment rate, and on the whole, as a result of economic hollowing. The logic is that increasing imports from developing countries where wages are low, corresponding labor-intensive industries in America will become comparatively disadvantaged, where the wages of laborers working for corresponding industries were reduced. Employment in these industries has greatly decreased and laborers who lost their jobs in the labor-intensive sector had no choice but to find work in the service-sector where wages are much lower and this has become the main factor of the expansion of the wage disparity in America.

However, where the expansion of imports from developing countries is a factor of income disparity or not is a matter of opinion. Scholars such as Krugmann (1995), Lawrence (1993) and Slaughter (1995) are sceptical of the above argument. Krugmann explains the effect imports from developing countries have on advanced countries by using a factor price equalization theorem. Firstly, it assumes that an advanced country that has a relatively large number of skilled workers begins trade with a developing country that has a relatively large number of unskilled workers. From this, the advanced country exports goods that economic blocks that would emerge. This concern has been quite acute in Europe, namely

France and Germany, where apprehension of world trade is connected to labor and environmental standards.

This essay surveys the transition of recent discussions of the OECD in America and Europe (Germany and France) and Japan regarding the effects of economic hollowing.

The Hollowing of the American Economy

As a result of a policy to maintain a strong dollar under the Regan administration, the U. S. economy in the early '80's experienced an increase in imports and the expansion of direct investment. At the same time, the unemployment rate was also of concern. In 1986, an article in ***Business Week Magazine*** stated that the economy would "Hollow Out" which only raised concerns of its effect even more. However, as conversely effected in Europe, which will we mention in depth at a later point, the unemployment rate actually decreased in the late '80's. Some scholars such as Reich (1991) and Revenga (1992) related import expansion of low cost products with the increase in the equalization theory. What is different from Krugmann's is the point that in terms of monetary amounts, the share is small (due to low cost), in terms of quantity; it is not that low in America's trade with developing countries. In short, the difference is seen in the amount of trade or by quantity. Still, as low wage division is originally labor-intensive, it is stated that the impact to employment is large in proportion to the amount of trade. From such a standpoint, Leamer says that low wage division within America is becoming lower as a result of transfer of low wage division in the American manufacturing industry after the birth of NAFTA.

Leamer sought the cause of the widening of wage disparity mainly in developing countries such as Mexico where wages are lower than in the U. S., Borjas and Ramey (1993) say that the factor of the widening of wage disparity is related to broader import expansion. As an example, the American durable goods industry was formerly a workplace that paid large salaries to high school graduates. Expansion of wage disparity in America is occurring with the increase of deficit balance of durable goods industries and the reduction of this industry is said to be one of the factors of the expansion in wage disparities.

Sachs, Shatz (1994) points out that trade with developing countries has an effect on both skilled workers and unskilled workers through the expansion of the trade deficit in case of America. According to this, when manufacturing industries in America are divided into 10 stages from low skill to high skill, the balance with developing course is a deficit except in the first section which is the highest (See table 1). In particular, the tenth section, which has the lowest technology, the width of deficit is large as well.

Table 1 Change of Trade Balances Affected by Technology (1978-90)

Skill Division	Balance w/LDC	Balance w/D. C.	Total
1	0. 2%	12. 2%	12. 3%
2	− 0. 9%	0. 9%	0. 0%
3	− 2. 8%	− 1. 7%	− 4. 4%
4	− 2. 3%	− 1. 7%	− 4. 4%
5	− 2. 0%	− 1. 6%	− 3. 6%
6	− 5. 5%	− 2. 4%	− 7. 9%
7	− 5. 2%	− 1. 4%	− 6. 6%
8	− 2. 6%	− 2. 1%	− 4. 7%
9	− 3. 4%	− 6. 7%	−10. 1%
10	−23. 5%	− 3. 6%	−27. 1%
Total Production	− 5. 7%	− 0. 2%	− 5. 9%
Blue Collar Lab.	− 6. 2%	− 0. 0%	− 7. 2%
White Collar Lab.	− 4. 3%	− 1. 0%	− 2. 1%

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However, in our discussion, there is the prerequisite that unskilled workers cannot be skilled workers in America. If unskilled workers can catch up easily to skilled workers, unskilled workers can easily enter into the skilled worker market where demand has expanded by trade. In that case, unskilled workers can earn higher wages by entering into the skilled worker market.

The Hollowing of the European Economy

Discussion of the economic hollowing out of Europe began in the '70's when the unemployment rate began to increase. Even today in Germany and France, it is argued that economic hollowing is to be blamed for the increase in unemployment that has occurred in the '90's in both countries.

Germany:

In Germany, the unemployment rate reached double digits in 1996 and the question of employment has become a critical political problem. In the September 1995 issue of the *German Economic Research Institute*, under the anonymously written title "Does the former West Germany have a location problem?" analysed the problems that Germany industries are experiencing in the midst of increased foreign investment.

In this thesis, it states that the former West Germany suffers from three economic problems. 1) High wage standards, short work hours, rigid labor market, high electricity expenses and high taxes, 2) competition from lower cost regions due to the liberalization of the Eastern European market, 3) lagging behind Japan and America in advanced technology. It also indicated that it is indispensable to deal with these problems in order to maintain global competitiveness in the future. Based on this, as a result of collectively taking many economic indicators into consideration, and it is concluded that productivity of the German economy is still the most efficient country in the world and cannot be said that the condition of location became more acute when it is compared with other OECD countries.

Still, in addressing the raise in unemployment from 1994 to 1995, it postured that it was basically due to business recession and not because of direct foreign investment from abroad.

However, due to the increase in the unemployment rate in the latter half of 1995, concern that domestic employment might be substituted for overseas employment due to direct investment has come to be expressed. This is partly because of statements made by German companies. For example, the Mercedes-Benz Corporation announced that it would establish a new plant in Brazil investing 400 million dollars in October of 1995.

Such enthusiasm for overseas direct investment by German companies and an increase in the unemployment rate in Germany has further enhanced the concern of the hollowing out of the domestic economy.

France:

In France, the unemployment rate reached double digits since '92 and the question of the effect of economic hollowing was even worse than in Germany. Addressing this issue two reports were written by investigators. A report written by Arthius (1993) says that employment in France has decreased as much as 470, 000 due to direct investment in the past 15 years. In reality, regardless of the fact that the share of final goods imported from Asia is small, interest in its influence is large. In a report published by the Agency for Foreign Economics at the Finance Ministry (DREE) in 1994, the correlation between the influence of high unemployment and the effects of economic hollowing are strong. However, in the Industry Statistics division at the Ministry of Industry and Communication (SESSI-Direction Generale des Strategies Industrielles) conducted a questionnaire centering on multinational firms in France (both French and multi-nationally owned) and analysed the influence of inter-firm trade. According to the survey results announced in June 1995, when seen from the French side, inter-firm trade in companies enforcing direct overseas investment in France was surplus by 139 billion francs in 1993 and inter-firm trade in foreign companies in France was at a surplus of 1. 8 billion

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francs. Therefore, it is said that activities of multinational firms in France have a positive effect on the country's economy.

In this manner, the French government is denying the opinion that trade and activities by multinational firms are causing the hollowing out of the French economy, though on the other hand, it also suggests the necessity of continuing the study on relations between employment and trade in the employment summit that took place in April of 1996.

The Hollowing of the Japanese Economy

It seems that it was around the period when the yen appreciation depression occurred soon after the Plaza Accord when anxiety about economic hollowing first was mentioned in Japan. It was Higuchi (1989) who saw the influence on employment in this period of rapid appreciation of the yen after the Plaza Accord. It is mentioned that there was a negative impact on middle-aged wage earners due to rapid appreciation of the yen. It seems this is because it is favorable for middle-aged men to remain in their former workplace in spite of low wages, as dislocation cost is high. However, business conditions recovered in the latter half of 1986 after the Plaza Accord and as the situation of the lasting business boom continued after that, the problem of hollowing out for the time being was shelved.

As the bubble economy collapsed in the '90's and the Japanese economy became to stagnate relatively more than in other developed countries, the discussion of hollowing out began to increase once again. What was most sensitive to this was the Japanese government's white papers which differed in opinion on whether investment and import expansion actually bring about economic hollowing or not.

In government related reports, the Economic Planning Agency of Japan was relatively optimistic about the hollowing out of Japan. In the white paper on the World Economy (1994), imports of industrial products from developing countries to advanced countries including Japan has increased and as a result of this, the possibility that the employment of unskilled workers has increased in advanced countries cannot be denied. That is, the effect on employment in advanced countries by import expansion of developing countries is said to be small.

In this type of industry where competitive power is decreasing in the manufacturing industry as in the case of Japan, the decrease of em ployment brought by import expansion from developing countries is not connected directly with the decrease of employment as a whole manufacturing industry the Economic Survey of Japan (1995) says.

It is pointed out that there is a possibility that the acceleration of foreign production will deteriorate the ability of domestic research and development that a white paper on International Trade (1996) stated. In a white paper on medium and small sized enterprises (1995), effects on the Japanese macro economy by overseas production are divided into three parts, the effect to induce exports, the reverse import effect and the export substitution effect by using the interindustry relations table and the total of these three was made into the gross amount of the effect on the macro economy. As a result of this, the effect on domestic production in Japan has been negative since fiscal 1986. However, when it is seen by scale, it is mentioned that a minus effect was larger in large-scale firms than in medium and small sized firms.

Conclusion

It is the factor price equalization theorem that supports the hollowing out argument of industry in America. Given that substitutability is poor between skilled workers and unskilled workers when workers are divided into two, unemployment will occur with unskilled workers who have been comparatively disadvantaged in developed countries. At the same time, supposing that there is substitutability between skilled workers and unskilled workers, as skilled workers will be absorbed into skilled worker division where demand is growing more that in advanced countries, there is a possibility that this effect will be cancelled out.

What will happen if this argument is applied to Japan? First of all, imports of final goods in Japan is when it is compared with that of America, we can see the characteristics shared by developing countries is large and the ratio is increasing year by year. This means, from the standpoint of the factor price equalization theorem, there is a possibility that this will affect employment even more.

However, in the case of Japan, it is a big question whether the market for skilled workers and unskilled workers are divided like that of America or not. In the case of Japan, it can be considered that even an unskilled worker has hidden potential to become a skilled worker. This can be thought to diminish the effect of the hollowing out of Japan.

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