Some Perspectives on Globalisation

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ABSTRACT

Much has been written about globalisation. Something truly insightful rarely comes to light. This article is no such attempt, it merely attempts to reconcile disparate views and tie some loose strands on the subject of increasing international integration. More specifically, the features and implications of current trade and investment patterns are awarded attention. The prominence of technological innovation is emphasised, as is the role of FDI in the diffusion of technical progress. Globalisation has implications both for developing and developed economies; for instance, its effect on growth, the consequences for macroeconomic stability and the effect on income inequality – particularly for low-skilled workers. Trade invites arbitrage in social values; social tension and populist demands for protectionism arise from this. Also, globalisation heightens economic risk and while the pressure on governments to mitigate this rises, their ability to respond effectively is dwindling, eroding the social consensus required to maintain open markets.

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INTRODUCTION

Although generalised use of the term "globalisation" stems from recent times, more or less the 1980s, the concept is by no means new or even modern. A centuries-old debate has acquired a new face and this article attempts to highlight some of its prominent features.

Globalisation refers to the increased integration of national economies through predominantly trade and financial flows. However, it also refers to increased production linkages, a growing web of treaties and institutions and the movement of people and knowledge. In virtually every year since the Second World War, the growth in international trade has outstripped the expansion in world gross domestic product (GDP). The upsurge in cross-border financial flows is perhaps the most obvious manifestation of globalisation; these flows have grown more rapidly than trade, and foreign direct investment (FDI) has increased faster than overall capital flows. The cross-border purchases of bond and equities in the G-7 countries have grown from approximately 4 per cent of the annual gross national product (GNP) of these countries in 1975 to 200 per cent in 2000. Presently, cross-border securities transactions exceed GNP for several large countries. In addition, the daily turnover in foreign exchange in private markets is greater than the entire reserve holdings of the central banks of the world and amounts to nearly twenty times world output (Crockett, 1999: 178).

Many measures, however, would indicate that the world economy was more integrated at the height of the gold standard in the late 19th century than it is now. In the United States and Europe, trade volumes peaked before the First World War, collapsed during the inter-war years and surged again after 1950. Conventional measures of openness, for example the ratio of trade to national income, indicate that the United States and Europe are not significantly more open now than a century ago. Japan currently exports less of its output than during the inter-war years (Rodrik, 2000: 229). The phenomenon of highly integrated national economies is therefore nothing new.

The dynamics of late 20th century globalisation varies from that of the late 19th century imperialist expansion. Underlying patterns may be similar, but the specific forms of integration are quite different. Trade flows have changed from inter-sectoral to intra-industry and intra-firm trade. Capital flows have shifted from the primary sector to the manufacturing and service sectors and from developing country recipients to developed country recipients. Financial flows have changed from productive investment by banks to largely unproductive but lucrative activities by institutional investors. Rigid immigration laws have replaced relatively unrestricted mobility of labour (Sachs, 2000: 218 and Crockett, 1999: 179).

In addition, key participants have changed from imperial nation states to large multinationals representing international industrial capital and financial interests. Gun-boat diplomacy has made way for market diplomacy of industrial and finance capital, negotiated by multilateral institutions. It is argued that both periods of international integration displayed a striking asymmetry. The asymmetry in the present system has emerged from the willingness of developing countries to provide access to their markets without corresponding access to technology and to accept capital mobility without corresponding access to labour mobility (Nayyar, 1997: 5).

PERSPECTIVES ON THE CURRENT STATE OF INTERNATIONAL TRADE AND INVESTMENT

During the last two decades, the erosion of geographical and market barriers has gained massive momentum and appears irreversible. The present tide of globalisation has developed distinct characteristics; some promising, others controversial and a few of them truly undesired. A prominent feature is the profound role of recent advances in technology. Technological innovation is generally acclaimed as the driving force behind globalisation and has transformed economic processes in almost every sector, but fundamentally so in the financial sector. The information available to economic agents has greatly increased, while the cost of cross-border transactions has been reduced dramatically. Traditional structures and methods of providing financial services have become obsolete. Complex new financial instruments and innovative ways of hedging against risks have evolved. Many administrative restrictions and controls previously characterising the financial system have been rendered ineffective (Crockett, 2000: 183).

In short, technological advance has enormously enhanced the ability to make economic judgements and act on them. It has become easier and faster to complete international transactions. It has also defined the relationship between rich and poor as acutely as any divisive ideology.

Second, the flow of modern trade and investment has adopted a particular profile, the global economic implications of which have sparked more than heated debate; the recent G-8 summit finally witnessed a fatality following vehement protesting. Globalisation has implications for both the developing and developed world; prominent among these are the following: the effect of globalisation on growth, the consequences for macroeconomic stability and the effect on income inequality – particularly for low-skilled workers. The World Trade Organisation (WTO) has had at least some part in the evolution of current trade patterns. A brief look at the current state of the WTO, its recent successes and immediate challenges may shed some light on the international phenomena presently perceived (Sachs, 2000b: 99).

Third, multi-national businesses, which serve as the most important vehicle for FDI, are at centre-stage in the globalisation process. The size, direction and composition of FDI affect the size, direction and composition of world trade and *vice versa*. FDI is generally viewed as a gateway to financial resources to supplement domestic savings, to firm-specific foreign technology, to high-quality managerial skills and to global distribution networks. Multinationals take advantage of intra-firm and international division of labour and facilitate smooth trade flows in correspondence with comparative and competitive advantage. This inflows have, however, become very concentrated. In addition, mergers and acquisitions appear to be the most favoured route to production abroad with parent companies based in developed countries. Consequently, control over the bulk of international production resides with the world's 100 largest multinationals – that is, with no more than 0.3 per cent of multinational businesses (Gupta, 1997: 3).

Finally, the issue of trade in global values has to be considered. Heightened integration not only facilitates arbitrage in the markets for goods, services, labour and capital, but also exerts pressure towards another kind of arbitrage: arbitrage in national norms and social institutions. This is a consequence of the rising cost of maintaining divergent social arrangements. Open trade may come into conflict with long-standing social contracts that provide varying degrees of protection against the relentlessness of the free market. Tension may clearly arise from this. Related to the issue of trade in social values, is the social pressure stemming from the consequences – or, more correctly, casualties – following the heightened competition imposed by globalisation. The need for social insurance and safety nets has anything but diminished. Coupled with retreating governments and reduced social obligations, the pressure on governments to mitigate the risks of globalisation may prove to be a future source of tension (Rodrik, 2000: 233).

Each of these features of modern trade, i.e. the role of technology, the implications of modern trade and investment patterns, the role of FDI and the social repercussions of globalisation, is now addressed.

THE TECHNOLOGICAL DIVIDE

The end of the cold war signalled the end of old ideological divisions. However, a new, more intractable division is taking hold. At the core of this global divide, is the vast inequality in technological innovation and diffusion. Nearly all technological innovation is undertaken by some 15 per cent of the globe's population, while perhaps a further 50 per cent has the ability to adopt these in production and consumption. The remainder of the world's population – approximately a third – is neither innovating nor adopting foreign technologically and remains predictably disconnected and in the grip of a poverty trap (Sachs, 2000b: 99).

Ironically, these regions' greatest obstacles require technological solutions inaccessible to them. If the technology is available offshore, it is often unaffordable on the required scale. Alternatively, the appropriate form of technology is non-existing and the incentives for local research and development (R&D) inadequate. The technologically-excluded two billion people may graduate to techquate. The technologically-excluded two billion people may graduate to technology-adopters and even innovators and then reap the benefits of globalisation, but this transition is everything but automatic.

Conventionally, development has been viewed as the outcome of the accumulation of physical and human capital. Less-developed countries where capital is scarce and the return on new investment high, presumably have an advantage to attract offshore capital and encourage saving, provided that they are well governed. This should promote convergence – that is, the narrowing of the rich-poor gap (*op. cit.*: 99).

Technology is less likely to converge. Increasing returns to scale in innovation favours environments already rich in advanced technology. Existing ideas are recombined to produce chain reactions of innovation. However, a critical mass of ideas, technology and a market sizeable enough to support R&D are prerequisites. In addition, the public-goods aspect of innovation requires academia, government and industry to work in harness. In poor countries, cooperation of this nature is virtually unheard of; they rarely even have an official scientific adviser.

Technological capacity can also be adopted via the following channels: the import of technology embodied in capital and consumer goods, licensing from patent holders, or FDI. All three instances require that the importing country should be successfully exporting to afford the foreign technology. Geographical considerations are also important. Not all developing countries are equally well located to absorb technology; proximity to big markets and principal sea routes attracts technology, whereas remote mountainous regions, landlocked developing regions and regions far from seaports generally fail to do so.

Failure to keep up with global technology often leads to the collapse of a country; they are unable to maintain living standards, much less improve it. They rely on a limited range of primary exports with declining profitability. The continual deterioration in their terms of trade is itself a side effect of technological innovation. In addition, demographic pressures resulting from rapid population growth exacerbate their plight. Urbanisation, the education of women and a reduction in childhood mortality eventually lead to reduced fertility, but these factors are subdued in technologically-stagnant regions. Demographic strain also adds to environmental harms like deforestation (*op. cit.*: 100).

The international globalisation strategy needs to be reconsidered on several fronts, failing which two billion or more of the global population may be excluded from the benefits of global growth. The issues of public health and the control of infectious disease require more than sharpened attention: a serious effort in terms of donor support would be the start of the battle against debilitating and lethal disease.

Marginalised regions need to be connected to the world economy with a focus on market access for the poor countries. Global shipping has become cartelised, with the trade routes linking marginal traders with major markets far less competitive than high-volume routes. Preferential approaches to some marginalised regions have been advantageous for immediate beneficiaries, but more remote regions then forfeit even more trade and FDI. Information technology (IT) offers the opportunity to overcome distance and should present the comparative advantage possibilities for landlocked regions. This would require the support and deliberate effort of these countries' political leadership in cooperation with leaders in the IT industry (*op. cit.*: 101).

The problem at the core of the global divide is the huge inequality in the innovation and diffusion of technology. Existing grants and lending to promote science and technology in the developing world are vastly inadequate. In addition, grant aid should be targeted on knowledge. A global technological strategy should focus on participation from academia, government and industry, also from the first world. Long-term collaborative research coupled with public funding aimed at push-strategies subsidising R&D efforts directed at poor-country problems and pull-strategies comprising rich-country commitments to buy new technologies on behalf of poor countries. In short, the global community should, on government level, firmly commit themselves to the promotion of scientific and technological capacity in poor countries.

GLOBAL IMPLICATIONS OF THE NEW TRADE MODELS

In *The Wealth of Nations*, Adam Smith declared that the discovery of America and a passage to the East Indies by the Cape of Good Hope are the greatest and most important events in the history of mankind. His vision was one of dynamic, mutual gains from trade – a unified world enabling the most distant regions to relieve each other's wants and encourage each other's industry. Even Smith later conceded that imperialist expansion deprived the native inhabitants of the New World and the East Indies of the benefits of globalisation. More recently, mutually beneficial trade was, at least from the perspective of the developing world, frustrated by two world wars, the Great Depression and four decades of protectionism following the Second World War (Sachs, 2000a: 219). One has to wonder whether the present tide of globalisation will finally see Smith's vision of globally advantageous trade into fruition.

Growth and gains from trade

The concept of dynamic gains from trade continues to be at the core of endogenous growth models. Long-term growth depends on heightened innovation and productivity. The incentives for both of these depend on the scope of the market, as was envisaged by Smith two and a half centuries previously. True enough, the rapidly growing developing countries of the past twenty years have been the ones to successfully establish new export growth, particularly in manufactures. Isolationist economies sheltering behind high trade barriers have not grown nearly as rapidly.

The manufactured exports originating from the fast-growing, export-led developing world exemplify a further principle strongly advocated by Smith – that of the benefits of international division of labour. In virtually all cases, these exports are part of a sophisticated system of labour division. Final goods are produced in multi-site operations, the labour-intensive processes of which are reserved for the developing countries (*op. cit.*: 220). The result is a complementary production relationship between advanced and developing economies – a situation unthinkable during the early, protectionist post-war days. Theoretically, globalisation could benefit both sides of the income divide: the scope of developed countries' market for innovation is expanded and developing countries get to share in the advantages of those innovations and to participate in global production.

However, as is empirically known and demonstrated by exceptions to standard theory, the gains in growth are not necessarily shared by all. The chances for extensive and beneficial trade are extremely limited in geographically isolated regions. The cost of transport between a national economy and world markets should be low enough to permit substantial interaction and gains from trade. Paul Krugman has pointed out that increasing returns to scale coupled with high transport cost may result in an accidental concentration of economic activity in some regions at the expense of others. Adverse climates – that is, climates conducive to infectious disease and poor agricultural conditions – may also impose obstacles to development, despite the generally beneficial effects of globalisation (Sachs, 2000a: 221).

The dynamic "Dutch disease" effect presents a further exception to the Smithsian tenet of mutually beneficial trade. Producers of natural resources might get trapped in an unsatisfactory specialisation of trade and in the process block the industrialisation necessary for economic development. This happens when a country successfully exports natural resources, strengthening its currency and undermining the competitiveness of nonresource-based industries. The specialisation in primary goods rather than manufactures, which offer better opportunities for long-term productivity growth, leads to long-term loss of growth. Empirical findings suggest that countries with large natural resource bases are uncompetitive in most manufacturing sectors and are hampered by low long-term growth. The reason for this probably is that manufacturing offers better opportunity for innovation and increased productivity in the long run. In principle, some form of non-market intervention, like the protection or subsidisation of manufacturing may remedy a case of Dutch disease, but these measures are subject to heated debate and international controversy.

Global stability

Economic theory predicts that countries will gain from trade in financial assets in ways similar to trade in goods. The potential gains from international financial trade are two-fold: it allows greater diversification of risk and allows a national economy to intertemporally optimise investment and consumption patterns. Recent experiences, for example the Mexican crash and the East Asian financial crisis, have illustrated how globally destabilising unfettered financial flows from advanced to developing economies could be. Globalisation appears to amplify rather than dampen certain key financial market weaknesses.

Globalisation of the capital markets has also had immensely beneficial consequences. Emerging markets had access to a larger pool of savings to augment resources available for development. Foreign investment has also served as vehicle for the transfer of managerial know-how, encouraging productivity growth, and market disciplines rapidly curtailed unsustainable policy developments. Globalisation imposed increased competition, significantly reducing the margin between the interest rates paid by users of funds and the returns received by savers in major financial centres. The development of new financial instruments has also offered market participants greater protection against a broader range of financial risk. All of this enhanced the efficiency of resource use and the rate of output growth (Crockett, 1999: 180 and Sachs, 2000a: 221).

Simultaneously, the increased size, sophistication and complexity of the financial system have led to greater costs when a crisis strikes. In addition to dramatic output losses, domestic absorption and living standards suffered a harsh blow in the affected economies due to the reversal of capital flows and enforced turnaround in the current account of the balance of payments. Capital inflows on average added 6 per cent to the spending power in the East Asian economies. After the crisis, capital outflows reduced spending power with 9,5 per cent (Crockett, 1997: 181).

Three types of instability associated with globalised capital markets emerged during recent years. They are the volatility in international capital flows, contagion of crises to economies previously performing satisfactorily and internal financial fragility resulting from the capacity of national banking and financial sectors to develop deep-seated weaknesses that emerge during costly crises. These three are interrelated and the worst-case scenario is when they occur simultaneously, as was indeed the case during the East Asian crisis.

The excessive volatility of capital flows is the result of macro-economic policy weaknesses in borrowing countries and herd behaviour by lenders incited by inadequate information. In emerging economies performing satisfactorily for some time, lenders optimistically and unrealistically extrapolate the continuance of good times. Lenders then accept inflated collateral values, questionable fixed exchange rate policies and investment schemes. A cycle of euphoric capital inflows ends when economic weaknesses emerge, followed by a scramble for the exit. Thus, if a debtor starts to weaken, a panicked withdrawal of short-term loans by risk-averse creditors may rapidly lead to the illiquidity of the debtor and then to bankruptcy, even if the debtor is fundamentally sound. Both debtors and creditors lose during a financial panic, since it produces a pure loss of market value (Sachs, 2000a: 223).

Financial fragility in borrowing countries presents a second source of instability. As in the case of volatility in capital flows, financial fragility arises from banks and financial institutions having built up portfolios of loans and other claims reliant on the continuation of a strong domestic economy. Some further weaknesses are that underregulated and undercapitalised banks speculate rather recklessly with depositor funds, since profits are assumed to accrue to themselves, while losses are viewed as the responsibility of national governments. The international financial liberalisation of a poorly capitalised banking system invites over-borrowing and eventual crisis. Also, political interference in lending decisions, excessive lending to connected enterprises, currency and maturity mismatches, dependence on collateral with inflated values, the absence of effective bankruptcy legislation, weaknesses in internal controls and lax and inexperienced banking supervision have in some way contributed to a financially frail environment in emerging markets (Sachs, 2000a: 222).

The third, complex source of instability is contagion, or the transmission of economic disturbances. This transmission does not happen entirely indiscriminately; weaker economies are usually hardest hit. Although economies with sound policy and financial systems usually weather disturbances better, it served as no guarantee to escape financial turmoil. It is disturbing that also countries that had reasonably good domestic policies found their implementation threatened by external factors. Economies are rendered unnecessarily vulnerable by the tendency of certain categories of investors to countries into a specific asset class. In the short run then, prices move in accordance with what the market in general thinks, even if it deviates from fundamental indications. Put differently, it is the reactions of other market participants that have to be correctly anticipated, irrespective of whether they are well informed, rather than market fundamentals (Crockett, 1999: 182).

The dramatic experiences of the past decade have inspired second thoughts in many quarters, if not the officialdom in Washington, about the rapid liberalisation of international capital flows. The aim is to slow capital movements to prevent financial market panics, at least until the financial system has been strengthened by means of some necessary reforms and the underlying sources of market failure corrected.

Income distribution

Increased trade is alleged to have adverse effects on income distribution in advanced and developing economies. International economics theory predominantly deals with two types of trade. First, intra-industry trade, which occurs within an industry, in similar products and between similar countries. This kind of trade is based on the gains from specialisation under increasing returns to scale and results in a win-win situation for both parties; consumers in both trading countries benefit from a wider range of more reasonably priced products than would have been the case under autarky. In addition, no one suffers a loss of income, absolute or relative.

The second kind of trade, inter-industry trade, is motivated by differences in factor endowment. For example, the United States specialises in products that are intensive in technology, physical capital and skills, and imports inexpensive labour intensive products from Asia. According to standard trade theory, both inter-industry trading partners could gain overall, but workers within both may be worse off as a result of trade. Less skilled workers in the United States face increased low-wage competition, while skilled workers in Asia may lose their jobs as a result of skill-intensive imports from the Unites States. In general terms, the Heckscher-Ohlin-Samuelson theory of trade implies that unskilled workers in advanced economies may suffer a relative and even absolute decline in income, while the same applies for skilled workers in developing countries. Inter-industry trade is strongest between dissimilar countries, typically between advanced and developing countries. Therefore, the income-distributional implications of rich-poor country trade are particularly threatening to specific social groups; as a result, the increasing rich-poor country linkages have proven particularly challenging politically (Sachs, 2000a: 224).

A contentious issue is the rise in income inequality within advanced economies during the period of dramatic globalisation; more specifically, low-skilled workers in these countries, for example the United States, have suffered a loss of income. Although this is consistent with conventional trade theory, it is unlikely that trade is the sole cause of the widening income gap. Technological advance may also have contributed in the sense that it favours skilled workers. It is most likely a combination of globalisation and technological change that was responsible for the deterioration of unskilled wages in advanced economies, with the preponderant weight on technology according to recent studies. Globalisation may affect income distribution through additional channels not recognised by conventional trade models. The exposure to foreign low-wage competition may have reduced the bargaining power of union workers compared to capital. Capital mobility and the outsourcing of production have greatly increased the substitutability of labour across borders and also the economic insecurity confronting workers in addition to exerting downward pressure on their wages.

The suggestion that the growing income inequality is caused by more than inter-industry trade is supported by evidence from developing countries witnessing a similar rise in the salary premium of skilled workers. Although empirically unexamined, it appears as if the scale of the world market has dissimilar effects on skilled and unskilled workers. This has led to a global rise in the market premium for skilled workers, while the opposite is observed for unskilled workers (*op. cit.*: 224).

The World Trade Organisation

A prominent feature of globalisation is the increased harmonisation of economic institutions. There was a significant rise in international treaty obligations regarding trade, investment policy, tax policy, intellectual property rights, banking supervision, currency convertibility, foreign investment policy and even the control of bribery. An ever-expanding web of treaties links nations through multilateral, regional and bilateral obligations (Sachs, 2000a: 218). The World Trade Organisation (WTO) is not the only international organisation involved in the orchestration of freer trade and investment flows, but it is the only international institution specifically entrusted with the task and therefore the only one discussed here.

The WTO appears to be in a sound state. The results of the Uruguay Round have been implemented largely on schedule and two prominent liberalisation agreements have been signed since. The negotiations on financial services are continuing and may be concluded soon. The new dispute settlement procedures are operating smoothly and the single-undertaking nature of the WTO, combined with the accession of several middle- and lower-income developing countries, has given rise to an active WTO programme of technical assistance. Also, the

Ministerial Conference in Singapore resulted in a clear political endorsement of multilateralism (Blackhurst, 1997: 528).

Despite these successes, the WTO also faces a number of challenges. For instance, the integration of a large number of least-developed and other low-income developing countries into the WTO system is posing several difficulties. Many of the current members of the WTO and the majority of the countries in the process of acceding, find the "single undertaking" attached to WTO membership challenging. Two-thirds of the least developed WTO members have no representation in Geneva, which is problematic since the WTO is a member-driven organisation in which delegates participate more actively in daily activities than is true of other international economic organisations. These members also have vastly inadequate back-up support in their capitals. It is questionable whether these countries will be able to participate meaningfully in WTO negotiations and the demand for technical assistance will by far exceed the ability of the WTO Secretariat to deliver it (*op. cit.*: 530).

Further cause for concern is the threat that regionalism poses to multilateralism. During the post-war era, free-trade areas and customs unions complemented the multilateral trading system due to what now appears to be special circumstances or luck even. There is no reason to believe that the post-war complementarity will persist, partly because regional agreements can be either outward or inward orientated, and partly because of the controversy surrounding the operation of existing WTO rules and procedures governing regional agreements.

It may prove particularly challenging to deal with the backlash against globalisation. There are growing signs of a public reaction against the continued integration of the world economy due to the following alleged repercussions of increased trade and capital flows. For instance, job losses among the unskilled workers, the widening gap between skilled and unskilled wages and pressures for cutbacks in social welfare programmes. Critics in developing countries add their voices with the claim that globalisation is marginalising poor countries and widening the gap between rich and poor countries (*op. cit.*: 531). The response to these concerns will clearly include the WTO argument that a return to protectionism will only make matters worse. Governments are accused of a lack of candour regarding the effects of globalisation: although the nation as a whole benefits, some groups in the economy will lose. Similarly, although globalisation opens the door to tremendous opportunities, it also raises the cost of bad policies like inflexible labour markets, over-regulation, sub-standard education and crowding out of private investors due to chronic budget deficits.

The role of the WTO has been changing dramatically during the last decade, driven by the forces of globalisation, the collapse of central planning, the developing countries' willingness to embrace export-led growth strategies and the approaching near universal membership. Should these forces persist, it is envisaged, at least within WTO ranks, that the WTO may become the pre-eminent international economic organisation (*op. cit.*: 533).

FOREIGN DIRECT INVESTMENT

It has already been stressed that the diffusion of knowledge has been an important determinant of the post-war patterns of trade, growth and development. Foreign direct investment is intimately connected to the transfer of technology between nations and is therefore influential in the shaping of post-war economies. Its importance is however more than qualitative; FDI has expanded dramatically over the past two decades, following the removal of national barriers to capital movement. The vast majority of investment was between developed countries, particularly within the OECD.

As in the case of the trade models, the pattern of FDI flows suggests that conventional models, which stress relative factor endowments and relative factor costs to explain FDI, need to be augmented to explain the FDI flows between similar countries. Comparative advantage is viewed as historically contingent. Models explaining the location of production activities need to allow for imperfect competition, product differentiation, and the benefits from the agglomeration of complementary activities (Barrel & Pain, 1997: 1772). Two central determinants of the pattern of production and investment amongst advanced nations appear to be knowledge-based, firm-specific assets and the evolving structure of trade barriers between and within large regional markets, like the EU and NAFTA.

The existence of knowledge-based assets might, particularly in some industries, gradually lead to a substitution of FDI for exports. Firms are encouraged to rather undertake direct foreign investment than license foreign firms to undertake production. Firms producing tradeables may also invest abroad to improve market access or to bypass trade barriers. The internationalisation of production has coincided with a growth in regional trade agreements, where external barriers remain while internal barriers are gradually dismantled. Barrel and Pain report that non-tariff contingent barriers, like the instigation of anti-dumping cases, have significantly affected the scale and pattern of Japanese FDI in Europe and North America (*op. cit.*: 1773).

In order to understand the channels through which new technology continues to flow, it is important to understand the long-run determinants of FDI, in terms of the home country and industry and in terms of the host country. Barrel and Pain significant effect between sectors over time and innovating sectors invest more abroad. Barrel and Pain suggest that new products, processes and techniques may be expected to come with inward foreign investment (*op. cit.*: 1775). The same study found that the timing of foreign investment was affected by domestic financial factors, such as interest gearing, the ratio of interest payments to cash flow, business sector profitability and the growth of real equity prices. The preferred indicator varied from country to country. Tighter domestic financial conditions are associated with a lower level of foreign investment. Exchange rate stability and labour market conditions in the host country were found to affect the ability to attract inward investment

FDI may alter the production possibilities of a host country since it is primarily undertaken by technologically progressive sectors and comes with new technologies and additional capital. Resistance against FDI is experienced in many developed countries; the benefits of FDI are alleged to be limited because it predominantly consists of mergers and acquisitions rather than investment in greenfield sites (*op. cit.*: 1777). In all likelihood, the reorganisation of existing capacity and introduction of new ideas associated with take-overs may raise the rate of technical progress and long-run growth potential without adding to final demand directly. Microeconomic evidence indicates that the spill-over effect of these inflows of new technologies and working practices from multinationals may significantly benefit local firms in the host country. Foreign ownership is viewed as more than the relabelling of companies; it is the potential transformation of economies (*op. cit.*: 1778).

It is widely acknowledged that inward FDI has raised the growth rate in many developing countries. Less is known about its impact on economic performance in developed economies, for example the European economies. US affiliates have a greater propensity to undertake R&D and a higher average labour productivity than domestic firms in European host countries. Manufacturing activities received a particularly high level of inward investment; this has proven important in the economic development of smaller European economies such as Belgium and Ireland. It is also claimed that inward FDI has contributed to the supply-side transformation in the United Kingdom. Also, the contribution of foreign affiliates to employment and exports in the tradeables sector of many economies is rising. However, this offers no proof that inward investment has also served to raise the income levels of the factors of production in the host economies. Preliminary studies indicate that FDI flows may potentially affect the pace of economic growth in advanced economies, but that it is not the only factor behind the growth in technical progress or total factor productivity (*op. cit.*: 1782).

FDI not only affects patterns of output and technical progress; it also affects trade patterns. The effect of inward investment on trade is simply that it changes the range and technological profile of host-country output, which profile is an important determinant of trade performance. Outward investment may serve as a complement to exports either by enhancing market access and sales facilities, or as a substitute for them. FDI in low-cost locations might also raise imports and substitute domestic production in the home country. Often the additional flow of income from existing investment in knowledge eventually raises national income.

Although both inward and outward investment may create or substitute for exports under particular circumstances, there appears to be a complementary relationship between inward investment and exports, while the evidence regarding the relationship between outward investment and export performance is generally mixed. Early cross-sectional studies indicated a complementary relationship; it was later reported that both FDI and exports have risen due to general economic growth and that there is little evidence of substitution between outward investment and exports. This fails to address the crucial question of whether rising FDI enhances or inhibits national export performance (*op. cit.*: 1783). Later studies were consistent with the hypothesis that, on average, multinational companies shift their production of exports from home to host countries. Barrel and Pain found that net outward stock has a significant effect on export performance, with a higher level of net outward FDI negatively related to exports over time. This suggests that FDI benefits host countries, while it is not without cost to the home country. However, a full general equilibrium cross-country analysis is required to take account of endogenous linkages between trade, investment and technological change.

GLOBALISATION, SOCIAL VALUES AND THE GOVERNMENT

Labelling everyone ill at ease with the consequences of international economic integration a self-interested protectionist does not contribute to the understanding of why broad popular support for free trade is lacking. Trade distributes income among nations. A defense of free trade cannot be constructed without addressing the issue of fairness and legitimacy of the practices that generate the distributional cost.

Traditional trade theory treats divergent sets of values, norms and institutions like any other differences that determine a country's comparative advantage. The source of a nation's comparative advantage matters, however. For instance, low-wage foreign competition arising from an abundant labour force is different from competition based on foreign labour practices that violate domestic social norms. A scenario where history and demography give rise to low wages is very different from one where government repression of unions results in low wages (Rodrik, 2000: 234). Trade invites arbitrage in national norms and social values. It may come into conflict with long-standing social contracts and becomes contentious when it unleashes forces that undermine social norms; hence the widespread populist reaction to globalisation. Once it is recognised that trade has implications for domestic norms and social arrangements and that its legitimacy depends on its compatibility with these, the notions of fair trade and leveling of the playing field are not as ridiculous as they are often made out to be by purists.

The anxieties generated by globalisation should also be seen in context of the expanding demands on national governments to perform social-welfare functions. It was only during the postwar period that it became part of governments' agenda to ensure adequate levels of employment, to establish social safety nets, to provide medical and social insurance and to care for the poor. The implicit postwar social bargain in the advanced economies included the provision of social insurance and safety nets – or some form of safeguarding against heightened economic risk – in exchange for the adoption of freer trade policies. This bargain is falling apart. Employers are less willing and less able to provide benefits like job security, because increased global mobility has reduced their dependence on the goodwill of the local labour force and because of increased competition. Governments' ability to sustain social safety nets is eroded, partly because of the increased mobility of capital rendering part of the tax base footloose, but also because the ideological onslaught against the welfare state paralysed them to respond to the social needs of a more integrated economy (*op. cit.*: 230).

Empirically, there is a strong correlation across countries between the degree of exposure to trade and the importance of government in an economy. The positive association between openness to trade and the amount of spending on social programmes is not confined to OECD – or advanced – economies. The same pattern is observed in developing economies. Rodrik (2000: 232) concludes that the social welfare state appears to be the flip side of the open economy.

The dilemma posed by globalisation is the following: it simultaneously increases the demand for social insurance and constrains the ability of governments to respond to that demand. It is to be expected that, as international integration progresses, the social consensus required to maintain the openness of domestic markets weakens. Social safety nets played a vital role in enabling the postwar trade expansion and if allowed to dwindle, the tension between globalisation and the demands to mitigate economic risk may give rise to protectionist pressures.

CONCLUSION

Phases of a high degree of economic integration are a historical phenomenon – in its current guise it is referred to as globalisation. The influence of globalisation over the evolution of the world economy has become highly contentious. Some believe it to be at a crossroad. It has undoubtedly generated unprecedented prosperity, but has also witnessed a widening rich-poor gap – within advanced countries, and between the developed and the developing world.

Several distinct features characterise current globalisation; among them the prominence of technological innovation and diffusion, and foreign direct investment. Moreover, a particular trade pattern has evolved and although globalisation benefits nations overall, clearly not everybody stands to gain from it – a truth not conveyed by the political process canvassing for public support of open markets. In addition to undesired economic ramifications, such as an altered income distribution, harming low-wage earners in developed and developing economies, and the increased likelihood of financial crises, social values and implicit social agreements are threatened. This erodes the social consensus required to maintain open trade and gives rise to populist demands for fair trade. The need for social security and safety nets to mitigate economic risk in an increasingly competitive environment is rising at a time when the capacity of governments to meet these demands is diminishing. In an era where the welfare state is on the retreat, tension between the forces of globalisation and social needs is mounting.

Clearly a return to protectionism is inconceivable. The tide of globalisation is in all likelihood irreversible in any case. In its current form, however, the weaknesses are only too apparent and will have to be addressed. This cannot be achieved by the institution of trade barriers and other guises of protectionism, but by appropriate international trade policy and political candour to safeguard the potential gains from trade and investment to be reaped from open world markets.

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