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newsletter

Leverhulme Centre for Research on Globalisation and Economic Policy

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GEP

Leverhulme Centre

for Research on Globalisation and Economic Policy

WHAT MIGHT GLOBALISATION'S CRITICS BELIEVE?

As part of The World Economy Annual Lecture Series ***Professor Deardorff*** *considered how the criticisms of 'globalisation' might be modelled within a coherent theoretical framework . A large number of the criticisms of capitalism centre on the 'use and abuse' of power by large corporations. As such this requires the need for alternative economic models. This article, a summary of that lecture, considers their possible structure. Alan Deardorff is Professor of Economics and Public Policy at the University of Michigan.*

Critics of globalisation object to many things, some of which can be easily understood within standard economic models, others of which seem to reflect a view of the world that economists generally do not share. In this paper I attempt to identify several alternative frameworks for analysis within which some of their criticisms may be understood. My ultimate aim, though not achieved in this paper, is to extract testable implications that differ from standard models and that might make it possible to distinguish among them empirically.

One does not need an alternative model to understand several objections to the configuration of the current global economic regime. Economists can easily subscribe to criticisms that industrialized countries have failed to open their markets sufficiently to the exports of developing countries, in textiles and apparel most obviously, but also in their use of administered protection and their agricultural subsidies. Many of us are also critical of the Trade Related Intellectual Property (TRIPs) agreement of the World Trade Organization (WTO), which provides incentive for

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FANCY A STAY AT THE HOTEL CALIFORNIA?

Governments around the world provide large incentives to attract multinational firms. Under a title inspired by the song 'Hotel California' *by the* Eagles ***Holger Görg*** *asks the question whether the costs of exit are also important: namely, the effects of profit taxation and the hire-and-fire cost of labour. Holger is a Lecturer in the School of Economics and an Internal Research Fellow in GEP. This is a summary of GEP Working Paper No.02/30.*

Many countries around the globe actively attempt to attract multinationals by offering generous investment incentives. For example, the British Government provided the equivalent of an estimated $30,000 and $50,000 per employee to attract Samsung and Siemens respectively to the North East of England in the late 1990s. Across the Atlantic, the Government of Alabama paid the equivalent of $150,000 per employee to Mercedes for locating its new plant in the

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FANCY A STAY AT THE HOTEL CALIFORNIA? CONTD….

state in 1994. Corporate tax rates are also used actively as policy tools to attract MNCs. A prominent example among European countries is the Republic of Ireland, currently charging only a low nominal tax rate of 10 percent on corporate profits. These incentives are at least partly aimed at reducing entry and operational costs for foreign firms and thereby make the location more attractive to them compared to alternative locations.

This is all very well and makes a certain amount of economic sense. For those inclined to listen to the odd 70s pop song now and again, this may also sound very much like the opening lines of *Hotel California*, released by *The Eagles* in 1976:

Welcome to the Hotel California, such a lovely place, such a lovely face;

Plenty of room at the Hotel California, any time of year, you can find it here.

Those who know the song will, of course, also know the ending:

Relax said the nightman, we are programed to receive;

You can check out any time you like, but you can never leave!

Thinking as an economist, this song reminds one that there are not only entry costs (and investment incentives which reduce those) to think about but there are also potential costs of exiting the market if things go wrong. When investigating questions as to where multinationals locate, why they do so and what their potential effects are on the host location, this issue seems to have been largely neglected, however. A number of studies have found that multinationals are attracted to locations offering generous incentives (be it grants or tax incentives) – suggesting that an appealing looking *Hotel California* type host country is able to lure in multinationals. However, the issue of how important potential exit costs are for location decisions of multinationals has received far less attention thus far.

A recent research paper attempts to fill this gap in the literature by looking in some detail at the trade off between investment incentives and exit costs for the location of foreign direct investment (FDI). While there has been some recent theoretical work investigating this issue, there does not appear to be any prior empirical work in this area. The empirical analysis considers the effect of profit taxation (as a measure of investment incentives) and an index of hiring and firing costs (proxying exit costs) on the location of US outward FDI in 33 host countries around the globe over the period 1986 - 1996.

The empirical work is embedded into a theoretical framework that considers entry and exit under uncertainty, based on options pricing theory. The data for the analysis are taken from a number of sources. Data on US outward FDI come from the US Bureau of Economic Analysis, data on taxation are calculated from US corporate income tax returns and the exit cost data are taken from the World Economic Forum, which conducts regular interviews with managers on how they perceive the competitiveness of countries. Further data for control variables are obtained from statistics provided by the World Bank.

The econometric analysis using these data shows a number of interesting results. Overall, the study finds that US FDI is negatively affected by the level of profit taxation and firing costs in the host location. However, this relationship holds only for FDI in manufacturing, not in services industries. Based on the theoretical model, this may suggest that sunk investment costs are less important in the latter than in the former sector, although it may also be consistent with other explanations. There is only limited evidence that the effects of firing costs and taxation differ between developed and developing countries. These results are robust to a number of different specifications of the empirical model.

These results provide an important, yet heretofore neglected conclusion. If countries want to attract FDI, in particular in manufacturing, it may not suffice that incentives are provided in order to ease the entry of multinationals. Instead, it also appears to be important that exit costs are at a level attractive to multinationals. This includes, for example, such factors as redundancy payments, ease of firing of workers, etc.

> ***"If countries want to attract FDI….it may not suffice that incentives are provided in order to ease the entry of multinationals. Instead it also appears to be important that exit costs are at a level attractive to multinationals"***

Recalling the song, it seems that just having a "lovely place" in Hotel California may not be enough to win new (multinationals) customers – if they are not allowed to leave easily.

WHAT MIGHT GLOBALISATION'S CRITICS BELIEVE? CONTD…...

innovation and creativity at the cost of a massive transfer from poor countries to rich countries. And many trade economists, at least, have become increasingly sceptical of the benefits of unfettered international mobility of short-term financial capital. All of these are objections that appear in at least some of the writings of globalisation's critics.

But other criticisms that have been voiced in that abundant literature make little sense in terms of standard economic models. These criticisms mostly seem to be focused on the role of large corporations and on the owners and managers of corporate capital, to whom are ascribed perverse motivations and/or excessive power that the critics believe have enabled them to hold down wages, worsen working conditions and despoil the environment. These criticisms reflect a view of the world that is clearly different from the economists' standard model of profit-maximizing, price-taking, perfectly competitive firms, and it is not clear that customary allowance for imperfect competition will help much. Thus the need for alternative models to reflect the critics' views.

> ***"the self-interest of corporations is just that, self interest, and when they exert that influence outside of markets there is no guarantee—no invisible hand—that can be counted on to make that influence beneficial"***

Three such alternative models are suggested here, all of which focus mainly on the behaviour of owners and managers of corporate capital. The first is an "anti-labour model," in which capitalists are willing to sacrifice some of their own profits for the chance to make labour worse off. Adding this assumption to an otherwise standard economic model yields at least two implications that diverge from standard theory. With this anti-labour motivation, firms that have the potential for making profits will choose to employ less labour and produce less output than they would if they were maximizing profit. Potentially observable conditions for profit-maximizing behaviour are therefore violated. Second, if such firms experience an exogenous increase in labour productivity, then, subject to an assumption on demand for their product, they will reduce employment when a profit-maximizing firm would increase it.

The second model is a "labour-monopsony model" in which capitalists cooperate globally to increase profits by depressing wages. This assumption, also placed in an otherwise standard economic model, likewise has implications that distinguish it from both the standard model and the anti-labour model.

The third alternative model discussed here is really more of a suggestion for a class of models rather than a well-formulated model in itself and I call it an "international political economy model." In it, capitalists use their resources to influence the political process for more than just obtaining import protection, as they would in the standard models of the political economy of trade policy. This third framework has capitalists seeking policies such as export subsidies and other means of promoting market access. It also, more importantly, has them influencing the international negotiations that set the rules of international agreements and organizations, such as the NAFTA and the WTO. Examples of the latter sort of influence are discussed, including the rules of origin and Chapter 11 of the NAFTA, and the TRIPs and GATS (General Agreement on Trade in Services) agreements in the WTO.

3 ALTERNATIVE MODELS:

1) ANTI-LABOUR MODEL
2) LABOUR MONOPSONY MODEL
3) INTERNATIONAL POLITICAL ECONOMY MODEL

Although the paper does not include any formal analysis or testing of these alternative models, attention to these issues has led me to some change in views, or at least in emphasis, regarding globalization. I am less comfortable than before in dismissing my own criticisms of the global system as mere anomalies. And I am now much more attuned than I was before to the role that corporate capital seems to play in setting the rules for the international economy. That role is not necessarily bad; corporations have been a powerful force in pushing the world economy towards freer trade and open markets, as well as advancing technology and satisfying the needs of consumers. But the self interest of corporations is just that, self interest, and when they exert that influence outside of markets there is no guarantee – no invisible hand – that can be counted on to make that influence beneficial.

GEP Conference on

Trade and Labour Perspectives on Worker Turnover

Leverhulme Centre for Research on Globalisation and Economic Policy

27th and 28th June 2003

Convened by

Dr Richard Upward and Dr Peter Wright *(University of Nottingham)*

Professor Carl Davidson and Professor Steve Matusz *(Michigan State University)*

Trade economists and labour economists have tended to treat the movement of workers between jobs, or between labour market states, very differently. Trade economists have relied on general equilibrium models focusing on the characteristics of pre- and post-trade equilibria. Labour economists, in contrast, have focused more on the process of adjustment itself and on the potential costs of adjustment in terms of, for example, unemployment or loss of earnings. This Conference will draw together economists specialising in both trade and labour economics to discuss these issues in the context of increasing international trade, cross-border investment and migration.

We are pleased to announce that the conference will be preceded by the *World Economy Annual Lecture*, which this year will be given by Professor Richard Freeman (Harvard University) on the subject of "The impact of trade and immigration on labour markets".

Topics to be covered include:

- Models of unemployment and turnover in open economies
- The political economy of worker turnover and international trade
- Theories of migration and international factor mobility
- Skill upgrading and flows of workers between occupations
- Fragmentation of production and job flows
- Flows of jobs and workers in transition economies
- Permanent and temporary job flows and real exchange rates

Confirmed speakers include:

David Brown *(Heriot-Watt University)*

Don Davis *(Columbia University)*

Barbara Dluhosch *(Universität der Bundeswehr Hamburg)*

Carsten Eckel (University of Passau)

Hartmut Lehmann *(Heriot-Watt University)*

Chris Magee *(Bucknell University)*

John McClaren *(University of Virginia)*

Devashish Mitra *(Syracuse University)*

Catia Montagna *(University of Dundee)*

Nina Pavcnik *(Dartmouth College)*

Scott Schuh *(Federal Reserve Bank of Boston)*

Albert Schweinberger *(Universität Konstanz)*

Globalisation: Threat or Opportunity?

This is a summary of a recent lecture given by ***Lord Peston*** *as part of the* Leverhulme Globalisation Lecture Series. *In his talk he summarised the costs and benefits to the global economy from globalisation but also the lessons that could be learned by policy makers and the economics research community. Lord Peston is a member of the House of Lords and was the chair of the recent House of Lords Economic Affairs Committee Enquiry into Globalisation.*

I start by giving a typical economist's answer to the question, namely that globalisation is both a threat and an opportunity. It is an opportunity because it opens up markets, provides access to ideas and more broadly extends the range of human experience. It is a threat because it exposes existing practices to competition, this competition being not simply one of economics but also of culture, and, indeed, of ways of life. Moreover, even for those countries that wish to open themselves more to the outside world, so to speak, the ability to cope with change, especially in the short term, may be limited.

In discussing all this I do not offer a straightforward definition of globalisation. I content myself with noting some of its salient characteristics. One of these is the enormous increase in the speed and, perhaps more importantly, the reliability of communication. It is of interest to note, however, that the rise of electronic communication, a process which is nowhere near its end, while it has adversely affected older means, has not led to their obliteration. Conventional methods, not least face to face communication, remain important. I for one would argue that what is surprising is the extent to which "old fashioned meetings and talk and the like" still have such a large part to play. A comment I make en passant is whether we are moving increasingly to the use of a single language for global communication. This relates to the dominance of a few forms of computer software. On the latter, I take the view that we should not be over impressed by the status quo. Somewhere out there someone is already devising the processes that will lead to the downfall of Microsoft. Similarly, while one notes the large decline in real transport costs, location still seems to loom large in a company's decision making and, for activities such as finance, concentration in certain centres remains a dominant consideration. Next I refer to the great significance of brands. While branded goods comprise only a fraction of world expenditure, their growth in economic and cultural terms is remarkable and is one of the distinctive characteristics of the world in which we live. Economic theorising which ignores both the competitive and monopolistic aspects of brands will make serious errors.

Lord Peston during his Leverhulme Globalisation Lecture

Having referred to location, another thing economists must recognise is the limitation of the traditional Ricardian trade model. At the least we must bear in mind that if "country X has a comparative advantage in good A", this may cause country Y's firms to locate there or buy into country X's firms, rather than simply import from X. Furthermore, the market response to competitive comparative advantage does not tell the

GLOBALISATION THREAT OR OPPORTUNITY? CONTD…..

whole story. There is also a political response based on a desire for protection from so-called unfair competition. The political response is as old as the hills. My point is that those who fail to see a downside to globalisation for poor countries fail to appreciate that in practice vested interests in rich countries may act to prevent them from achieving its benefits.

What emerges most clearly from the evidence that my Committee has gathered is that globalisation ought to be interpreted as a continuing process which is far from equilibrium. I am not even sure how one would define an equilibrium in this case. Remarkable things are happening in China and India too is moving forward and has great potential to accelerate. One may also be fairly optimistic about the economic prospects of some of the Eastern European countries that may be joining the EU. But one should not exaggerate the prospects for success in all cases. There are serious grounds for worry in Russia, where it is a question whether the many forces for good will overcome those for harm. Equally, while there are again some grounds for optimism in parts of Africa, there are also strong grounds for pessimism.

Much of the pessimism does not derive from the purely economic side. It is connected with political instability and corruption, and lack of administrative and managerial skills. I lack the expertise to pronounce on this but there are a few useful points that an economist can make. One is that there is a two way relationship between institutional structure and economic performance. As a matter of history, it is not true that a first class set of institutions is a prerequisite of economic success. Corruption, for example, was rife in the US while it was making rapid economic progress. This was also true of some countries that participated in the so-called Asia miracle. Many countries of Western Europe were far from democracies while their economies made great improvements. This does not mean that institutional reform is irrelevant. It does mean that it is only part of what is required. Economists would also emphasise that, if administrative skills are scarce, we have to ask how best they can be employed. The same applies to law enforcement. To take a practical example, it may not be a top priority for a country to concentrate on protecting intellectual property when other aspects of law enforcement may be more productive.

Central to the recommendations of our report is that while there are economic realities that countries cannot ignore, how they adapt to global markets must be sensitive to their own circumstances. This is true of both the speed and scale of adaptation. There is not one model of economic success but several. In the past the global institutions did not seem to recognise this. In my judgement their approach was more ideological than scientific. They are, however, now in the process of change and the IMF, for example, is showing some signs of recognising that its role should be more of a guide and a facilitator, and not an external dictator, or a Moses bringing down the tablets of economic wisdom.

Finally, I come to some questions which deserve an answer but on which we cannot pronounce with great confidence. One is whether world markets are more competitive. All the TNCs will tell you how much they are subject to competitive pressures. It is easy, however, to point to a high degree of market dominance in many cases and to the continuation of many restrictive practices. Resale price maintenance, for example, although supposedly outlawed in most countries, exists in practice to a very large degree. Indeed, almost all world brands try to control the retail distribution of their products, including their prices. More important than that, of course, is the continuing high degree of market protection and the difficulties that are placed in the way of poor countries endeavouring to enter rich countries' markets. (The word 'hypocrisy' leaps to mind.) A second question is whether there has

> *"the IMF.. is showing signs of recognising that its role should be more of a guide and a facilitator, and not an external dictator, or a Moses bringing down the tablets of economic wisdom"*

been a rise in financial instability. My own answer is in the negative but I think I am in a minority. Thirdly, if free trade and free movement of capital are desirable, what about free movement of labour? Here too I argue that the economic analysis that shows the net benefits of freedom in all other markets must apply to the labour market. Once again, I am afraid to say I am in a minority.

The World Economy Annual Lecture 2003

Professor Richard Freeman

Harvard University

‘The impact of trade and immigration on labour markets’

26th June 2003

At the University of Nottingham

Public Lecture; all welcome

Leverhulme Globalisation Lecture

Martin Wolf

Chief Economics Commentator *The Financial Times*

‘Financial Integration Today and a Century Ago’

30th April 2003

At the University of Nottingham

No tickets required; all welcome

Second GEP Annual Postgraduate Conference at the University of Nottingham 10th April, 2003

Programme

TRADE AND LABOUR MARKETS IN EUROPE

Foreign Outsourcing towards newly industrialised countries and its impact on the relative wages and employment of low skilled workers in the European Union **Michel Dumont (University of Antwerp)**

Trade liberalisation and the sustainability of cross-border union coordination. **Chiara Strozzi (University of Modena)**

POSTER SESSION: TRADE AND DEVELOPMENT TOPICS

The Importance of Geography for Firm-Level Exports, Presenter: **Pamina Koenig Soubeyran (University of Paris)**

South-South Trade: Geography Matters, Presenter: **Souleymane Coulibaly (Universities of Lausanne and Paris)**

Border Effects and East-West Integration, Presenter: **Angela Cheptea (University of Paris)**

From Globalisation to Technological Change to Relative Wages, Presenter: **Alexander Hijzen (University of Nottingham)**

MICROECONOMIC EVIDENCE ON EXPORTS AND PRODUCTIVITY

Exporting by Learning? Microeconomic Evidence from British Automotive and Chemical Industry **Zhihong Yu (GEP, University of Nottingham)**

Foreign Acquisition of Export Firms: Evidence from the UK manufacturing sector 1987-1996 **Mauro Pisu (GEP, University of Nottingham)**

TRADE, DEVELOPMENT AND MOVEMENT OF FACTORS

Does North-South Trade affect Multinational Firms Strategies? **Sylvie Montout (University of Paris)**

The Determinants of Mobility Towards Self-Employment in Colombia: a Duration Analysis **Valentine Henrard (University of Paris)**

POSTER SESSION: DEVELOPMENT TOPICS

Objective Repayment Rates in Bangladesh and their Determinants: How to Improve the Efficiency of the Attribution of Loans by MFIs? , **Marie Godquin (University of Paris)**

Competition and Growth in a Neo-Schumpeterian Model , Presenter: **Piercarlo Zanchettin (University of Nottingham)**

Alcohol Prohibition and Addictive Consumption in India, Presenter: **Lupin Rahman (London School of Economics)**

Inequality and Welfare Analysis in the Harris-Todaro Model, Presenter: **Yarika Ruangsiri (University of Nottingham)**

DEVELOPMENT AND INSTITUTIONS

Threshold Effects in the Openness-Productivity Growth Relationship: Role of Institutions and Natural Barriers **Michael Henry (GEP, University of Nottingham)**

The Role of Freedom, Growth and Religion in the Taste for Revolution **Sylvia Pezzini (London School of Economics)**

Visitors to GEP 2002/3

October	November	December
Arvind Panagariya *University of Maryland*	Dr Joakim Gullstrand *Lund University* Dr Catia Montagna *Dundee University* Dr Fredrik Sjöholm *Stockholm School of Economics*	Professor Alan Deardorff *University of Michigan*
January	**March**	**April**
Professor Ray Riezman *University of Iowa*	Professor Carl Davidson *Michigan State University* Professor Todd Sandler *University of Southern California*	Dr Joakim Gullstrand *Lund University*
May	**June**	**November**
Professor Steven Matusz *Michigan State University* Professor Wolfgang Keller *University of Texas* Professor Bruce Blonigen *University of Oregon*	Professor Richard Freeman *Harvard University*	Professor Kala Krishna *Penn State University*

Conference on

Exporting and Firm Level Adjustment

University of Nottingham

Monday 6th October 2003

details from Sue Berry: Sue.Berry@nottingham.ac.uk

New GEP Studentships 2003/04

GEP is pleased to announce that 2 studentships are available for 2003/4. For more information please see the GEP website.

Current PhD Students: Since its inception, *GEP* has co-funded a number of Research Students with the University. The first cohort of students have now completed their PhDs. Current students are focusing on the following topics:

Olga Babouchkina is investigating the extent to which differences in labour market structures, across countries, affect the extent of firm-provided training and in particular whether greater labour market 'flexibility' might reduce incentives for firms and workers to engage in training.

Saileshsingh Gunessee has just started his PhD in the Centre. He will be modelling tax competition between countries/regions and the effects that may have on the location of companies. He will address this issue using tools from experimental economics.

Michael Henry is examining the relationship between total factor productivity growth and openness at an aggregate country level. In addition to the traditional measures of openness commonly used in the literature he also intends to develop new measures.

Kittipong Jangkamolchaikul is undertaking a PhD thesis on the optimal level of FDI for developing countries. He is particularly interested in the mechanism for technology transfer from multinationals to indigenous

Baboo Nowbutsing is undertaking a PhD thesis on the impact of international trade on wages. The primary objective of the study is to test existing theories explaining the link between international trade and wages, through the application of experimental economics.

Satiumsingh Ragoobur is examining the impact of foreign competition on wage setting in the UK. Research is focusing on the effects of import competition on union wage differentials, how international competition affects wages, especially wages negotiated between unions and firms.

Sarut Wittayarungruangsri has begun work on anti-dumping, both its determinants and economic effects. His thesis will be primarily theoretical.

Zhihong Yu is working on the dynamics of firm adjustment into and out of exports markets. He will work on UK and Chinese data.

Ping Zhang is undertaking an experimental investigation of Initial Public Offerings auctions. The aim of her study is to compare the variety of mechanisms used around the world.

Workshop to support the work of the World Commission on the Social Dimension of Globalization

To be held at Department for International Development

Organised by Professor D. Greenaway & Dr O. Morrissey

David Greenaway and Oliver Morrissey are convening a Workshop on 8th April to support the work of the World Commission on the Social Dimension of Globalization. Key Speakers are:

Professor Augustin Fosu (*African Economics Research Consortium*)

'Trade and Labour Market Adjustment in Developing Countries'

Professor John Harriss (*London School of Economics*)

'Non-Economics Aspects of Labour Market Adjustment'

Professor Arne Bigsten (*University of Gothenburg*)

'Labour Market Adjustments and Policy Outcomes'

There will be over 20 participants from *inter alia* the Universities of Brasilia, Ghana, East Anglia, Bath, the European Commission, the ILO and several NGOs.

The World Commission on the Social Dimension of Globalization was established by the International Labour Organization (ILO) in February 2002. The Commission is an independent body. It was initiated to respond to the needs of people as they cope with the unprecedented changes that globalization has brought to their lives, their families and the societies in which they live. The Commission looks at the various facets of globalization, the diversity of public perceptions of the process, and its implications for economic and social progress. It searches for innovative ways of combining economic, social and environmental objectives, based on worldwide expertise. It will make its recommendations seeking to build upon a broad consensus among all key actors.

GLOBALISATION: OLD WINE IN NEW BOTTLES?

In January 2003 the *House of Lords Economic Affairs Committee Enquiry into Globalisation was published.* In 2001, **David Greenaway** provided evidence to that Committee*, chaired by Lord Peston. This article forms part of that submission. The full House of Lords Report is available on the GEP website. David Greenaway is Professor of Economics and the Centre Director of GEP at the University of Nottingham.*

The appellation 'globalisation' is a product of the 1990s; elements of the phenomenon are of a much earlier vintage. Globalisation has been, and continues to be, a catch-all term which, judging by mass demonstrations at Seattle, Prague, Genoa and elsewhere, seems to signify exploitation, inequality, environmental degradation to a disparate range of interest groups. In fact, the label describes a process whereby individual national economies become more interdependent, more 'joined up'. As a result, the well-being of residents in one country becomes more susceptible to (benign and malign) economic developments in other countries.

At its simplest, globalisation occurs when individual nation states export more of what they produce. Since the purpose of exports is to facilitate imports, globalisation occurs when the share of exports (imports) in GDP increases. A higher share of trade then means that any perturbation to exports or imports has a greater impact on real income. Over the post-World War II period, trade volumes have grown at unprecedented rates, averaging almost 6% per annum for 50 years. The value of merchandise exports globally now exceeds US$5.5 trillion and that of services exports US$1.4 trillion. More significantly, however, these growth rates have consistently outstripped the comparable growth rates of real output and average openness of economies, both developing and developed, has increased sharply. But this is not the first time this has occurred. Post World War II trade has grown from low levels created by the inter-war period of protectionism and beggar-thy-neighbour exchange rate policies. In the late nineteenth century, openness ratios were also very high and the international economy showed some similar features of globalisation.

To that extent, globalisation is not an entirely new phenomenon. However, the late twentieth/early twenty-first century vintage does have at least three new dimensions. One is its scale: more countries are part of the international economy and to a greater extent, than in the second half of the nineteenth century. For example, with the accession of China, the World Trade Organisation (WTO) will have 143 Members. The second difference is that cross-border investment by multinational enterprises is far more extensive, more pervasive in the sectors of economic activity it affects and more footloose between locations. In 1999 there were estimated to be 63,000 multinational enterprises, with 690,000 affiliates; the total stock of FDI exceeded US$6 trillion and annual flows were over US$500 billion. The fragmentation of production processes that has accompanied the growth of multinationals has increased interdependence and accelerated the speed with which perturbations are transmitted. Third, capital markets are deeper and more integrated, which facilitates rapid movement of capital and serves to accelerate response times.

Drivers of Globalisation

Sustained growth in real income per capita the second half of the twentieth century has fuelled increased demand for increased varieties of goods and services. However, the link between growth and globalisation is neither straightforwardly monocausal nor unidirectional. Interaction with other factors – a decline in man-made and natural barriers, technological development and the growth of the multinational enterprise – have also been crucial.

Man-made barriers in general, and tariff barriers in particular, fell sharply over the post World War II period. For example, at the end of the 1940s, average import tariffs on manufactures in the UK exceeded 40%, they now stand at around 4%. Similarly sharp declines can be observed across the OECD countries and more recently (though not to the same extent) in developing countries. These falls have provided an obvious stimulus to trade and investment and are the outcome largely of GATT/WTO orchestrated multilateral trade liberalisation or, in the case of developing countries, World Bank stimulated unilateral liberalisation. In addition, regional trade liberalisation has also contributed, especially in Western Europe and North America. Declining natural barriers have been even more dramatic. Freight charges for shipping are around 70 per cent of what they were in 1950; transatlantic telecom charges around 7 per cent; air passenger charges less than 50 per cent. Thus the costs of 'doing business' internationally have declined dramatically, yielding more and more by way of profitable opportunities. The proliferation of internet hosts and expansion of e-tailing and e-business internationally means that this trend will continue.

But, of course, falling costs of transportation and communication do not only facilitate 'armslength trade', i.e. making products in one country to be sold by some third party in another; it also facilitates fragmentation of the production process. In other words, it makes it easier for companies to 'slice up the value chain'. In practice, what this means is that companies source particular components or production processes internationally to take advantage of differences in labour costs and exploit scale economies. One outcome is more and more international trade in intermediate products and services. As noted earlier, this is associated with a dramatic increase in foreign direct investment, with growth rates exceeding even those for merchandise and services trade.

> *"globalisation is not an entirely new phenomenon. However, the late 20th early 21st century vintage does have…new dimensions."*

In sum, the fundamental drivers of globalisation are real forces that create an incentive to trade goods and services and for capital and labour to move internationally; and technological and institutional factors that make it easier to do so. But, of course, the liberalisation and integration of financial markets has been vitally important in facilitating the process by giving corporate bodies easier access to global capital markets.

Winners, Losers and National Policy

International exchange raises real incomes by allowing residents of an economy to consume more than they produce. Goods and services that are produced relatively efficiently (due to some combination of resource endowments and technology) are exported in exchange for commodities that can only be produced inefficiently. As a consequence, real incomes are higher than they would be without the exchange. Thus, in the long run, for any economy, globalisation is not a zero sum game: international exchange improves living standards through some combination of higher wages, better employment prospects and access to a wider array of cheaper goods and services. But this does not mean there will not be losers, particularly in the short run. Take a specific example: a concurrent increase in imports and exports raises employment in export sectors and lowers it in the sectors producing import substitutes. If labour can be quickly transferred from the former to the latter, rapid adjustment takes place. But, in practice, adjustment may be protracted because workers in the contracting sector do not have the skill sets to guarantee immediate employment in the expanding sector. Alternatively, they might have the right skill sets but live in the wrong place. In either case, they may become unemployed.

Increased globalisation creates more opportunities and therefore the potential for greater job turnover. Although the latter is a desirable characteristic of a dynamic well functioning economy, it also brings with it less job security. Thus one key function for national policy may be to put in place policies which either increase job security or increase adaptability. Legislative solutions to the former could reduce job turnover and transitional unemployment. However, since such solutions are also likely to reduce adaptability, they can also be associated with greater structural unemployment. The alternative approach is policies intended to remove barriers to and encourage adaptability. Obvious examples of the former are investments in both publicly provided and on the job training, since education confers transferable skills and encourages occupational and sectoral mobility. The benefits from such policies extend well beyond adjusting to globalisation and include adjusting more smoothly to changes in technology which, given computerisation and the communications revolution, are also accelerating. A respectable body of research also points to limited geographical mobility as a potential adjustment problem, caused at least in part by the very thin market for privately rented accommodation in the UK.

Policies aimed at improving the sectoral and occupational mobility of labour ultimately enhance the adaptability of the economy to change, whether this be driven by globalisation or by other factors, such as new technology. It may still, of course, be the case that some workers remain subject to a period of unemployment during the transition. Clearly then, national policy has a responsibility to provide appropriate social safety nets to protect those that bear the short term costs of adjustment, through income support.

Even if workers transfer quickly from contracting to expanding activities, those that continue to work in the former could end up with lower wages. In the UK, for example, export activities generally employ more highly skilled labour than import substitute activities. Rearrangement of workers between the two could lead to an increase in the 'skill premium', i.e. an increase in wage inequality. Evidence suggests that such an increase has indeed occurred in the UK (and to an even greater extent in the US). However, the evidence also suggests that this probably has much more to do with the fact that new technology has tended to be skill biased, rather than globalisation. That, of course, does not mean that there is no role for national policy. But it does point to the appropriate form of intervention being public policies targeted at income support and skill upgrading rather than policies intended to cut off or weaken interactions between the national and global economies. A great deal of evidence has now been accumulated

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which suggests that such protectionist policies are associated with slower growth in real incomes and a greater incidence of poverty.

International Policy Issues

A number of international agencies have been, and continue to be, central to the globalisation process and its management, most visibly GATT/WTO, the World Bank and the IMF. GATT/WTO has been at the heart of eight so-called 'Rounds' of multilateral trade negotiations between 1947 and 1994. Through time, these have become ever more extensive in their coverage of issues, ever more inclusive in terms of Contracting Parties and inevitably more complicated and protracted. It has been argued by some that WTO has outlived its usefulness on at least three counts: multilateral negotiations now extend well beyond the traditional fayre of tariff liberalisation; the proliferation of regional trading arrangements has subverted the WTO agenda; the agenda itself does not adequately address the needs of developing countries. These arguments are not sustainable. The agenda has broadened considerably and has made life more complicated. However, unilateral recourse to non-tariff measures (like voluntary export restraints) or 'fair trade' measures, which can have trade distorting effects (such as anti-dumping policies), are at least as costly as unilateral recourse to tariff measures. Some kind of supra-national authority is therefore in the interests of all, especially small countries and that, of course, means most developing countries. Moreover, the proliferation of regional trading arrangements (RTAs) reinforces this particular point. Few RTAs have a significant influence on trade and investment patterns: the EU is the exception here rather than the rule. As a 'large' country it can and does use its bargaining power and, like the other 'large' country in the system (the US), requires mechanisms to constrain that power.

There are three key functions that the WTO continues to fulfil. First, maintenance of momentum of multilateral trade negotiations, both on the so-called built-in agenda and on new issues. The former includes agriculture, services and intellectual property, all three of which figured on the Uruguay Round agenda for the first time. Important as they are, these in themselves do not justify a new Round. Globalisation has highlighted the potential impact of non-border measures like competition policy and investment measures, both of which are potentially within WTO 'jurisdiction'. Environmental issues are regarded by some as another new issue that should figure. Although it would probably be inappropriate for WTO to become an environmental organisation as such, it clearly has a responsibility to ensure that trading rules are environmentally friendly. A second crucial function for WTO is to provide an effective dispute settlement process. Trade related disputes inevitably arise. To avoid them triggering unilateral action and possible trade wars, effective dispute resolution mechanisms are essential, especially for small countries and developing countries. The third vital role of WTO is its 'audit function' through the Trade Policy Review Mechanism, whereby the trade and trade related policies of all Contracting Parties are subject to regular review.

Since the inception of its Structural Adjustment Programme in 1980, the World Bank has played a role in the globalisation process. Crudely, the Programme has disbursed concessional loan finance 'in exchange' for market based reforms, including liberalisation of trade and foreign exchange markets. The Programme has not been universally successful: in some countries reforms have been implemented and growth has followed, in others reforms have not proved to be sustainable. The Programme continues to be controversial, though there has been learning from experience. For instance, the Bank does appear to be more sensitive to the need for institution building and infrastructure support as pre-conditions for effective market oriented reforms. The organisation will continue to have a role to play in supporting the design and implementation of reform programmes; providing adjustment assistance to support short term losers; and, perhaps most importantly of all, in capacity building.

WTO and the World Bank are the two most important multilateral institutions where promotion and regulation of globalisation are concerned. It is important to acknowledge that other agencies also have a role to play, including: the IMF (financial support); OECD (international investment measures); ILO (labour standards) and WIPO (intellectual property).

Summary

Insofar as individuals have always traded across national boundaries throughout recorded history, we have always had globalisation. The modern version of the phenomenon is, however, more pervasive in that it impacts on more people in more countries. Moreover, the mechanisms by which economies become more 'joined up' are more varied: as well as more trade in goods and services, we have more fragmentation of production processes and more involvement of multinational enterprises in international commerce. On the one hand this means that the benefits of globalisation are more widely spread than ever before; on the other hand it also means that globalisation related change is more rapid and more pervasive. The role for both national policy and international regulation, therefore, is to facilitate the globalisation process to ensure that its benefits, in terms of higher real income, are harvested, whilst simultaneously acting to ensure that those minorities that bear the costs of adjustment are kept to a minimum and are appropriately supported.

Trade Openness: Hindrance to Growth and Poverty Reduction?

*The relationship between trade openness and economic growth has been subjected to much empirical research, especially over the last 15 years. Despite this there is no consensus as to its effectiveness in promoting economic development. Here **Arvind Panagariya** argues that openness is a necessary but not sufficient condition to promote growth. Arvind Panagariya is a Professor at the University of Maryland and a GEP External Fellow. He visited GEP in October 2002.*

Recent attacks on globalisation have also translated into attacks on the wisdom of outward-oriented *trade* policies for developing countries. Free trade skeptics question the desirability of these policies for promoting growth. As a corollary, in many cases, they blame growth failures on the surge of imports resulting from increased openness. They also view outward-oriented trade policies as socially detrimental in that they hurt the poor.

Does evidence support these assertions? The answer is a categorical no. In so far as developing countries are concerned, there is compelling evidence that openness is a necessary condition for rapid growth. There are few developing countries that have grown rapidly on a sustained basis during the post-second-World-War era without simultaneously experiencing rapid growth in their exports and imports. Because openness by itself is not *sufficient* to promote growth--macroeconomic stability, policy credibility and perhaps other policies must usually accompany it--one can surely find examples of countries opening up without experiencing growth. But this hardly constitutes an indictment of openness.

In a similar vein, countries that have achieved significant poverty reduction are generally those that have grown rapidly and have, in turn, been open to trade. The most obvious examples that come to mind are the Newly Industrialized Economies (NIEs) including Hong Kong, Singapore, Republic of Korea and Taiwan that have entirely eliminated poverty according to the commonly used dollar-a-day poverty line. On the other hand, countries such as India that remained autarkic and grew at less than 1.5 percent in per-capita terms until late seventies experienced little reduction in the trend poverty ratio.

In my own recent research, I have analyzed the data for a large number of countries for 38 years spanning over 1961 to 1999, made available by the Global Development Network. I divide these data into two 19-year periods and identify, for each period, what I call growth "miracles" and "debacles". The former include all countries that grow at 3 percent or more in per-capita terms and the latter those experiencing a decline in incomes in per-capita terms. I find that miracle countries invariably experience a very rapid expansion of exports and imports while debacle countries rarely do.

Thus, consider Table 1 and 2, which list all miracle and debacle countries, respectively, during 1961-80. Even though this period is commonly identified with import-substitution, the remarkable fact is that virtually all countries that grew rapidly did so while also expanding their exports and imports. The countries in this group come from virtually all continents with developing countries including Latin America, which is often described as having led the developing world in pursuit of import substitution. Brazil, which grew at 4.6 percent, expanded its exports and imports at 8.1 and 7.6 percent, respectively, during the period. Among countries that grew at 3.6 percent or more, the lowest recorded growth rate of imports was 7.2 percent for Tunisia, which grew at 4 percent in per-capita terms. Even as we go down the list, there are only two countries that register relatively low growth rates of imports: Mauritius and Kenya with import growth of 3.8 and 3.6 percent, respectively.

If we look at growth debacles as in Table 2, the weight of evidence is hugely against trade being the culprit. Out of the seven debacle cases in which we have data on trade, only two show significant growth in imports. In the other cases, declines in per-capita terms are accompanied by import growth of less than 2 percent.

The pattern captured in Tables 1 and 2 is repeated by data for 1981-99 (not shown here due to space limitations). The key difference is that the number of miracle countries in the latter period is smaller and that of debacle countries larger. But remarkably, the *total* population enjoying miracle growth rates at the beginning of the first period at 356.5 million was considerably smaller than that at the beginning of the second period at 2.1 billion. The popular belief that 1980s and 1990s were lost decades of development while 1960s represented the golden period of growth (as described by Dani Rodrik) is too simplistic. While it is true that the population experiencing a decline in per-capita terms during 1980-99 was much larger than in 1961-80, partially due to the implosion of the Soviet Union and East and Central European countries, the developing country population experiencing rising living standards in the developing countries during 1981-99 was also much larger on account of both China and India growing at 8.3 and 3.8 percent, respectively.

Critics often seize on the fact that openness by itself does not *always* lead to the resumption of growth. Why should a country take the painful decision if it is not going to result immediately in increased income? But this is

Table 1: Miracles of 1961-80

	Growth Rates %			Population in million
Country	GDP per capita	exports	imports	(1961)
Hong Kong	6.9	10.8	10.6	3.2
Gabon	6.6	10.6	12.1	0.5
Korea, Rep.	6.3	23.7	18.0	25.7
Lesotho	4.8	7.6	11.8	0.9
Trinidad & Tobago	4.7	3.8	9.1	0.9
Thailand	4.6	9.3	9.6	27.2
Brazil	4.6	8.1	7.6	75.0
Malaysia	4.4	6.9	7.2	8.4
Israel	4.2	10.8	8.1	2.2
Cote d'Ivoire	4.1	7.6	7.9	3.9
Tunisia	4.0	8.3	7.2	4.3
Ecuador	3.7	8.2	8.0	4.6
Dominican Republic	3.6	5.6	10.6	3.3
Ireland	3.6	8.0	7.8	2.8
Egypt	3.5	5.4	8.1	26.5
Indonesia	3.5	6.5	10.2	95.9

clearly a wrongheaded argument. Our ability to predict when and what will trigger the process of growth in a country is limited. What we do know, however, is that openness is almost always essential for it. Therefore, it makes sense to be ready with an open trade regime should the opportunity knock at the door. The point is duly illustrated by the contrasting postwar experiences of Korea and India until the late 1970s. Increased savings rates offered both countries growth opportunities but only Korea was able to take advantage of it. With its emphasis on producing everything domestically, including machinery, India choked off the growth potential it had created for itself.

On the poverty front, overwhelming evidence is that countries that grow rapidly also eradicate poverty faster. Once again, the Indian experience illustrates this: until late seventies when the economy grew at less than 1.5 percent per annum in per-capita terms, its trend poverty ratio showed little movement. It was only from the 1980s that India grew at above 3 percent and from when the poverty ratio began to see a significant decline. Thus, between 1980s and 200, the poverty ratio fell from 49 to 26 percent. In China, likewise, the poverty ratio fell from 28 percent in 1978 to 9 percent in 1998.

Recently, David Dollar and Art Kraay have collected more systematic evidence pointing to the connection among openness, growth and poverty reduction. They rank countries according to three criteria: increased openness to trade as measured by the rise in trade to GDP ratio, growth rates and reduction in poverty. It turns out that high performance countries according to one criterion are also high-performance countries according to the other criteria.

Thus, empirical evidence does point to openness being necessary for growth and rapid growth being almost necessary for significant poverty reduction. This does not rule out, however, the possibility that openness can hurt certain disadvantaged groups, especially in the short run. For example, liberalisation of auto sector is almost sure to make impoverished autoworkers at least temporarily. But this calls for adjustment assistance if the impoverishment is temporary and longer-term compensation if impoverishment is permanent and drives the workers below the poverty line. It hardly justifies denying the larger population the benefits of growth and poverty reduction.

Table 2: Debacles of 1961-81

	Growth Rates %			Population in million
Country	GDP per capita	Exports	Imports	(1961)
Central African Rep.	-0.1			1.6
Zambia	-0.3	1.0	0.4	3.2
Somalia	-0.4			2.9
Madagascar	-0.4	1.2	1.8	5.5
Dominica	-0.4			0.1
Ghana	-0.4	-2.7	-3.0	7.1
Guinea-Bissau	-0.5			0.5
Niger	-0.5	3.5	7.8	3.1
Senegal	-0.6	-0.1	1.2	3.3
Iran Islamic Rep	-0.7			22.1
Congo, Dep. Rep.	-0.9	2.8	5.7	15.7
UAE	-1.0			0.1
Chad	-1.9	1.4	0.8	3.1
Kuwait	-3.6			0.3

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