The Economics of Globalism *

"Globalism" means different things to different people. Some years ago, Vernon used the term to refer to the post World War II American vision of a world of "open global markets" operating under the surveillance of institutions "organized on a global basis" (Vernon and Spar 1989, pp. 1, 189). More recently it has been given a new, more dramatic interpretation. "We are living through a transformation that will rearrange the politics and economics of the coming century. There will be no *national* products or technologies, no national corporations, no national industries. There will no longer be national economies ... All borders will become ever more meaningless in economic terms" (Reich 1991, p. 3). The reason is increased international mobility of factors of production. "As almost every factor of production – money, technology, factories and equipment – moves effortlessly across national borders, the very idea of an American economy is becoming meaningless" (*ibid.*, p. 8).

Three main inferences are being drawn from this diagnosis of world economic trends. The first, emphasised by libertarian economists, is that "increasing international mobility of information, capital and people is undermining the ability of governments to control national economies" (Kasper 1990). The second and third are exemplified by two recent books, both of which argue in different ways that trade flows are no langer a good indicator of national competitiveness and that current account imbalances no longer matter much (Reich 1991, Julius 1990). All three are important claims if valid and therefore deserve some scrutiny.

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The End of Government Regulation?

"At the start of the 1990s, a new spectre is haunting the chancelries and backroom offices of the world – but this time it is not the spectre of Communism! All the powers of vested interests and government regulation now have to confront the consequences of a new international mobility of people, capital, enterprise and knowledge. The old order of nation states and national, sovereign policies will never be the same again, as the new international mobility is turning into a new historic force" (Kasper 1990, p. 2).

Kasper cites the exodus of people from bad regimes which governments have been unable to stop – from East Germany, Vietnam, the USSR – as examples of international mobility of labour, "international migration – legal and illegal, skilled and unskilled". He refers to the communications revolution which makes ideas travel faster – "as knowledge about distant places improves, people compare their own circumstances, institutions and governments much more critically with what is on offer elsewhere". He points out that capital is becoming much more footloose – "moving to locations where laws and regulations, taxes and work practices promise the highest returns". Finally, firms are increasingly shopping around – "globally competing, optimum-scale industries are increasingly operating out of locations where they enjoy entrepreneurial freedom" (*ibid.*). He concludes that "openness undermines the much vaunted 'primary of politics' over economic life ... In open societies, economic considerations and the positive-sum game of economic development will inevitably gain the upper hand over politics and collective controls – be they purportedly for 'social-justice', environmental or other reasons of social engineering". (Kasper, p. 5).

It is a vista to warm the heart of anyone of a "dry" persuasion. How realistic is it?

It could be argued that even in Europe increased factor mobility is the consequence rather than the cause of the political movement towards Europe 1992; and even Europe is unlikely to become a single national economy, such as that of the USA or Australia, for at least another decade or two. Nowhere else in the world does international factor mobility seem likely to make more than a marginal difference to national government control of national economies. International mobility of labour is far from making a significant difference to

relative levels of real wages. There is as yet no sign that the USA, Japan and the other 100-odd countries outside the EC are prepared to accept a single currency, with the coordination of macroeconomic policy this requires. And a reminder of the Common Agricultural Policy is enough to dampen hopes that the world will see free trade in goods and services in the foreseeable future.

The fundamental reason why it is difficult to share Kasper's optimism is that people are not as single-mindedly devoted to economic efficiency as the one criterion of policy as he. They do demand "social justice" and protection of "disadvantaged" groups and of the environment. And nationalism is, alas, alive and well everywhere – as recent developments in eastern Europe have amply demonstrated – not to mention religious fundamentalism. Public opinion therefore demands "social engineering" from national governments.

The End of National Competitiveness?

Central to the argument of both Julius and Reich is the rapid growth during the 1980s of foreign direct investment (FDI), especially among the developed countries, and the role of multinational ("global") companies producing offshore through subsidiaries. But their argument leads them to very different, indeed almost opposite, conclusions.

Reich argues – against the notion of "industrial policy" which he favoured in an earlier book – that it is pointless for the US Government to subsidise US companies most of whose output is produced by subsidiaries in other countries. In the paraphrase of one reviewer, "now that nations are no longer closed economic systems, efforts to build up an industry or company or technology produces advantages that tend to be enjoyed by people, companies, and countries other than the ones doing the building ... Washington's help would end up creating jobs, profits and opportunities in the very countries it was trying to stay ahead of – or catch up with. Corporate nationality is all but irrelevant. Whether a US-owned company is profitable and growing may have little connection with the economic fate of people living in the U.S. ... What matters is not what a nation or its

companies own, but the knowledge its people possess and the work their knowledge enables them to do" (Weaver 1991). He therefore rejects "industrial policy" and urges instead a renewed emphasis on social policy, mainly more and better education and expanded income-transfer programs to compensate for the depressed real incomes he anticipates for most Americans.

Reich's new scepticism about "industrial policy" is shared by many economists who doubt the ability of governments to pick winners, but Reich's argument hardly adds weight to their case. Certainly, US companies producing products through overseas subsidiaries generate income and employment in the host countries. But it does not follow that FDI by US-owned companies yields no benefit to the USA and its people. There is a presumption that the return on capital is higher abroad than on alternative investment in the USA, and offshore production may, by making the product and its brand name better known, help promote direct exports. While it may be the case that some US companies have become so "global" that their management no longer thinks of itself as American with a concern for US national interests, it is difficult to believe that the same applies, *mutatis mutandis*, to many Japanese, or even German or French, companies.

Whereas Reich virtually disowns the offshore operations of US multinational companies, Julius would want to make the most of them. In *The Economist's* summary of her argument, "now that capital and entrepreneurship are free to cross borders, the old trade measures may conceal as much as they reveal ... If America's "trade" balance is measured on the basis of nationality of ownership rather than residency (*i.e.* adding the sales, net of local purchases, of overseas subsidiaries to the recorded trade balances and deducting all intra-firm flows to avoid double counting) then in 1986 America's recorded visible-trade deficit of $144 billion is transformed into a $57 billion surplus" (*The Economist* 1991).

The rationale for this conjuring trick is a definition of national competitiveness as "the ability of a country's firms to compete in world markets, whether through export or overseas production ... The more a nation's companies locate factories abroad, the smaller will be that country's recorded exports, yet its manufacturers may still be expanding their share of world markets" and this is what matters to businessmen (*ibid.*).

Undoubtedly, Toyota thinks of the sales of cars by its Australian subsidiary, domestically or for export, as Toyota sales and will take them into account in assessing its share in the world market for cars. To the extent that the subsidiary is owned by the Japanese parent company, the subsidiary's profits (net of Australian tax) accrue to Toyota shareholders and to Japan's current account as investment income. But it is unreasonable to include the sales of Toyota's Australian subsidiary in Japanese exports, and therefore in Australian imports, precisely for the reason stressed by Reich, that the subsidiary generates income and employment also in Australia. As *The Economist* reviewer comments, Julius's measure of national competitiveness "would find few backers among politicians worried about jobs and living standards" (*The Economist* 1991). No less obviously, production of cars in Australia, in place of imports from Japan, on balance, improves Australia's current account.

One may concede to Reich and Julius that globalism tends to blur the nationality of multinational companies and that, in assessing market shares, offshore sales as well as direct exports are relevant. But to argue that, for either reason, the conventional definitions of foreign trade and competitiveness should be discarded seems to push the argument much too far.

The End of Balance of Payments Problems?

Both Reich and Julius deprecate undue concern about trade or current account imbalances, though for reasons quite different from those advanced by economists who, "only a few years ago claimed that current account deficits did not matter" (*The Economist* 1991).

Reich hardly touches on current account deficits, exchange rates and related issues, although at one point he admits that "problems arise if you spend the money you have borrowed at fancy restaurants and at the racetracks [which] is what the fortunate fifth of Americans did on a grand scale for much of the 1980s" (Reich, p. 265). But he does argue that it is foolish to discuss economic policy in national terms – which would seem to cover imbalances in international payments – for no better reason than that the concept of nationality is no longer relevant to global companies.

Julius staunchly asserts that "economic policy-makers give undue importance to indicators such as current account balances that are increasingly unsuited to the problems of managing integrated economies" (Julius 1990, p. 107; all page references to this book). But she does not in fact demonstrate that current account balances matter less than they used to or have become less responsive to exchange rate changes. Her two points are that "with integrated capital markets and floating exchange rates, the balance of payments has lost its former role as the authoritative summary of a country's external position" (p. 85) and that "in a world where foreign-owned firms are a more important vehicle for the integration of markets for goods and services, exchange rates are a less powerful instrument for economic management" (p. 12).

In support of the first point, she cites the facts that in recent years the return on US foreign investments "was considerably higher than the interest rates which were necessary to attract the foreign capital that financed the current account deficit" (p. 87) and that the market value of the UK's large foreign assets rose faster than that of foreign assets in the UK (p. 89). The fact, if it is a fact, that in both cases, through fortuitous circumstances, the current rate of net capital inflow was not reflected in a corresponding increase in the country's net external liabilities (valued at current market prices) hardly warrants rejection of the balance of payments on current account as, in general, the best *prima facie* guide to a country's external position.

Julius's second point rests on the proposition that "firms serving foreign markets through local subsidiaries can withstand large swings in exchange rates more easily" than firms exporting from a home base (p. 91). For example, a British bicycle company is exposed to less exchange risk in the event of a threatening depreciation of the franc if it produces the bicycles in France through a subsidiary than if it exports them from its UK plant. (Conversely, of course, it has less chance of a windfall gain from an appreciation of the franc.) "Widespread international operations with high local content provide shelter in foreign markets which simple export operations lack" (p. 87). Maybe so. But it surely does not follow that "exchange rate changes by themselves have less impact on external balances than they used to have" (p. 91). It is true that international capital movements are tending to inhibit equilibrating changes in exchange rates and to that extent to deprive national authorities of the exchange rate as an instrument for balance of payments adjustment.

But there is little reason to think, and little empirical evidence to suggest, that current account imbalances respond less readily to changes in exchange rates in a world economy in which global companies conduct their operations largely through foreign subsidiaries. Reduction, through diversification across national markets, of the exchange risk to which companies are exposed is one thing; reduction of the responsiveness of current account imbalances to change in exchange rates is quite another.

Globalism – the End of National Economies?

When both Reich and Julius argue that globalism is making it increasingly foolish to discuss economic policy in national terms or to worry about trade balances, they might be thought to be echoing the "new view", espoused by Corden and others (Corden 1977, 1990), that current account deficits and foreign debt do not matter if they are financed by private borrowing because one should assume that "private savings and investment decisions are optimal unless there are particular reasons to believe the contrary" (Corden 1990, p. 8). In fact, however, the two theories have little if anything in common.

Neither Reich nor Julius explicitly addreses the question whether current account deficits matter. The closest Julius comes to it is her statement, already quoted, that "with integrated capital markets and floating exchange rates, the balance of payments has lost its former role as the authoritative summary of a country's external position", but what she has in mind, as we have seen, is the need to include sales through overseas subsidiaries in a country's exports and the opportunities afforded to companies to reduce their exposure to exchange risk by across-country diversification. At most she would argue that increasing integration of world capital markets has made it easier to finance current account deficits. In contrast to the "new view", Julius and Reich would claim merely that "large deficits can be sustained for much longer" (*The Economist* 1991).

But through the argument of both Reich and Julius runs, like a red thread, the notion that globalism, the mighty force of "the rise of global markets for capital, labour, management and technology", is rendering national economic boundaries, and therefore *international* balances or imbalances of payments, increasingly obsolete. "Will

FDI-led integration of real markets", Julius asks, "result in a global economy and the demise of national economic barriers"? (p. 93).

We thus return to the question raised by Kasper's argument. Is the world becoming a single common market? Is there even a tendency in that direction, and are global companies with their FDI making a contribution to such a tendency?

Four decades of debate and negotiations about the European Common Market have highlighted and clarified the differences between national and (sub-national) regional economies. Balance of international payments matters while balance of interregional payments does not (or hardly) for four main reasons: Between regions of a national economy (*a*) capital is more mobile, (*b*) labour is more mobile, (*c*) trade is generally unimpeded by tariffs and other restrictions, and (*d*) national macroeconomic management minimises the emergence of major interregional divergences of levels of incomes and prices.[1] The *raison d'être* of national currencies is that exchange rate changes between them provide an additional degree of freedom when macroeconomic policy coordination, whether through the discipline of an international standard or through cooperation between national authorities, is inadequate to prevent the emergence of such divergences.

Substantial advances have been made in the EC in all four directions, though there is still quite a way to go. Capital has become highly mobile between member countries, labour also moves more freely, though much less so; trade barriers are on the way out, and there are hopes that agreement will be reached on sufficient macroeconomic policy coordination to make the ECU feasible as a single currency for the whole Community. Current account imbalances of individual member countries will matter less as these four objectives are approached.[2]

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[1] Interregional divergences of income and economic activity within a national economy may also be compensated by the fiscal system if taxation is progressive and expenditure responds to need. Except for aid (and perhaps military expenditure), this function of a national budget is missing internationally (KINDLEBERGER 1991).

[2] Even a single region within a national economy is not without balance of payments problems. If Tasmania were to suffer a drastic decline in export income, whether because of a fall in demand for some of its major export products or a fall in supply because of drought, its trade deficit would initially and for some time be financed automatically by intra-bank transfers, in effect overdrafts by head offices to their Tasmanian branches. But soon branch managers would be instructed to restrict credit to their customers or even call in overdrafts. With declining business confidence in Tasmania, investment from elsewhere would slow down. As employment and wages fall, labour would move to the mainland. Thus balance of interregional payments would be restored at a lower level of real wages and economic activity in Tasmania.

The world economy as a whole, or even the OECD area, is nowhere near even that degree of market integration, and there is little reason to believe that it ever will be. Admittedly, the greater international mobility of capital which has come with financial liberalisation has made it easier to sustain current account deficits. But even to this advance global companies are not necessarily making a significant contribution with their FDI. Of course, in so far as current account deficits are the *result* of FDI flows (in effect, the vehicle for real transfer of capital), there is no problem. But if a country runs into balance of payments difficulties, whether through a fall in its terms of trade or because domestic excess demand is spilling over into imports, FDI by global companies is of little help. If such deficits are nowadays easier to finance, it is because of greater ease of access to credit in the international money and capital market, not because of FDI which is more likely to be deterred than attracted in such circumstances.

Advances in the other three relevant directions – greater mobility of labour, reduction in trade barriers and macroeconomic policy coordination – outside and beyond the EC are stumbling at best, not sufficient now or in the foreseeable future to make a difference to the economic significance of national economic boundaries and international payments imbalances.

The role of global companies straddling world markets through the operation of their subsidiaries in many countries has various important implications which deserve attention and study. Declining information and transport costs are contributing to international factor mobility, and this is a trend to be greatly welcomed. But the definition of "globalism" as used in the two books discussed here does not help us to understand the increasingly interdependent world economy.

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