The Threat of Globalisation

The current debate on globalisation is very interesting because it raises such a wide variety of issues. The main concern of the International Forum on Globalisation (IFG) is 'the emergence and growth of corporate trade and banking institutions that are not accountable to democratic processes or even national government'. A full consideration on the consequences of this would lead us beyond the boundaries of economic thought but I will try to highlight what economic theory adds to the discussion and where available, show evidence to support these theories. I will therefore try to address the following questions raised in IFG's position statement. Is there any evidence to suggest that these transnational institutions are growing to the extent that they endanger national economic systems? How is globalisation affecting the returns to different factors of production in the various trading countries? And will globalisation result in the homogenisation of society into a 'global monoculture' (IFG 1995)

Anti-globalisation protestors fear that powerful corporations who have no base and are not subject to the rules of any one country are becoming a dominant global force. These transnational companies can move from one region to another taking advantage of cheap labour in India, research grants in the U.S, and lower taxes in Europe all at the same time. These companies are alleged to influence institutions like the WTO and World Bank who are driving for freer trade on commodities, services, and even capital. The United Nations Conference of Trade and Development (UNCTAD) currently believes that there are over 60,000 TNCs throughout the world which

together account for over $6 trillion in FDI. The 100 largest of these own a third of these assets and employ 13.3 million people worldwide. To help assess the rate of transnationalisation of these companies, UNCTAD has assigned a transnationality index to each company. This is the average of the ratios of foreign and total assets, foreign and total employment, and foreign and total sales. The largest 100 TNCs have an average transnationality index of 53% in 1999 compared to 50% in 1990. There is no doubt among observers that by using these statistics, FDI for the last 15 years in particular has been growing at a much faster rate than other economic indicators like GDP, or even international trade. Some use these figures to show that massive oil or car companies (many of whom are among the 100 largest TNCs) are beginning to dominate entire national economies. These figures should be put in perspective though. According to Hirst and Thompson (1999), inward FDI in the advanced countries only accounted for about 10% of GDP in most cases, which they believe is not enough to endanger a national economic system. Furthermore they show that figures issued by the UN are inflated estimates of actual investment as a consequence of normal liability management not to mention a massive increase in merger and acquisition activity in recent times. One final point made by Hirst and Thompson (1999), is that contrary to the claims of Julius (1990) and Ohmae (1990), governments do have a choice over economic policy decisions that can be represented by the differing extent of economic integration in different countries. They use figures on outward investment as a percentage of total investment, and foreign ownership of domestic corporate bonds to show that the differences between countries from before the 1980s have been maintained.

So fears are perhaps unfounded that TNCs are becoming too powerful, but there are those who argue that the current drive towards free international trade constitutes globalisation, and that there are dangers associated with this. Free trade is said to benefit large corporations leaving ordinary workers behind. Efforts by the WTO to reduce barriers to trade are alleged to be backed by capitalists and are therefore not in the interests of consumers and workers. To assess the credibility of these claims, I shall examine the grounds for and consequences of increased international trade. I will use the Hecksher-Ohlin-Samuelson model to do this because trade between countries with similar levels of technology dominates the international markets. This model assumes that capital and labour in both trading countries are fixed, that they can be split between production of X and Y and that they are homogeneous. Production of X is labour intensive and that of Y is capital intensive. Finally, goods and factor markets are perfectly competitive with no other distortions such as tax. Crucially, for my use of the model in this case, the level of technology in country H and F is identical but their factor endowments are different. That is country H is relatively well endowed with capital and country F is relatively well endowed with labour. It is important to note that relativity allows one country to have higher absolute supplies of both labour and capital.

Country H could concentrate completely on production of good X or of good Y,

$$X = f(L + K) \qquad Y = g(L + K)$$

but by doing so they would be using resources in production of one good that might be better used in production of the other. Therefore the production possibility frontier is concave. Note also that because country

H is well endowed with capital, it can produce more of capital-intensive good Y than labour intensive good X, hence the bias in the curve towards production of Y.

Because competitive firms wish to maximise profits, we can assume they will produce at some point along this PPF. The utility maximising consumers decide where. An important assumption made by economists in many trade models is that of community indifference curves (CIC). We can take an aggregate of all individual indifference curves to make a set of CIC. As long as trade is not allowed, production will take place at wherever the PPF is tangent to the CIC that is furthest from the origin. This is our autarkic point. One final point to make is that at this point the price ratio is equal to the slope of the PPF or the marginal rate of transformation (MRT). Mathematically,

$$p = p_x/p_y = MRT = -\Delta Y/\Delta X$$

(where p_x and p_y equal the respective prices of X and Y). Thus for given production functions and community preferences in autarky country H will produce and consume at A_h. Similarly with opposite factor endowments but facing the same production functions and community preferences, country F will produce and consume at A_f.

Allowing free trade means that producers face a new international price ratio as a result of the equalisation of prices. They now have an incentive to produce more of what they can export because the can receive a higher price for it. The Heckscher-Ohlin theorem states that 'a country will export the good which intensively uses its relatively abundant factor.' (Markusen et al 1995, p.106). So in country H, the price of good Y will rise while that of good X falls, causing consumers to prefer good X. Producers of X however see higher profits can be made by producing good Y and because factors are intersectorally mobile, they can do so. The resulting surplus of Y can be exported at the international price level. Finally, consumption will occur where the international price ratio is tangent to the CIC furthest from the origin.

Another consequence of free trade is the equalisation of factor returns. This is the consequence that labour unions in the developed world are concerned about. In our example, country H (we shall now assume to be the U.S.) experiences an increase in the price of capital-intensive good Y (which might be aeroplanes) and a decrease in price of labour-intensive good X (for example textiles).

The important consequence of different factor endowments in the two countries is that the resulting price ratios of goods X and Y are different. Therefore in country H, capital-intensive good Y is relatively cheap and labour-intensive good X is relatively expensive with the opposite being true in country F. Lowering the barriers to trade gives consumers in H access to the markets in country F, where they can buy the labour intensive good X more cheaply. Similarly, consumers in country F can buy good Y cheaply if they import it from country H. Producers in each country are then forced to adjust production to suit the new patterns of demand

In questioning globalisation, Hirst and Thompson (1995) investigate the flows of capital around the world and show

They suggest that negative consequences of this may include a reduction in the power of governments to control their own affairs. Although this is an important issue, worry from the perspective of an economist is the extreme pursuit of economic development with no consideration of health or ecological issues

There are those who assert that globalisation is desirable and use economic theory to show that all countries concerned can benefit from an increase in trade. Alternatively there are those who question whether globalisation is really happening and conclude that there are not as yet trans-national companies who

Julius (1990) and Ohmae (1990) claim that numerous TNCs within the developed world go wherever investors see a return on their investments. So during the 1980s a smart TNC would initiate operations in the emerging markets of Korea, Taiwan and Hong Kong. When confidence was broken in the 1990s it would withdraw its assets from East Asia and head for safer shores to take advantage of the 'new economy' in the U.S. This leads many to think that by examining capital flows one can identify transnational companies.