POLICY-MAKING IN A GLOBALISING WORLD ECONOMY

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Summary

The purpose of this paper is two-fold. The current trends driving the globalization process are first described. A key finding is the close connection between the emerging patterns of global foreign direct investment (FDI), those of world trade and those of international production networks. The internationalization of production stimulates trade flows between investment home and host countries and as cross-investments between countries proliferate. While intra-trade of countries of the Organization for Economic Co-operation and Development (OECD) still accounts for almost three-quarters of world trade, and intra-OECD foreign direct investment (FDI) for roughly 65 percent of total OECD outward FDI, these shares are declining and should continue to drop as barriers to trade and investment fall in developing and transition economies (non-OECD countries). Trade and investment flows have also grown dramatically among non-OECD countries over the last decade.

The globalization of economic activities has entailed a blurring of the identity of firms and of products, which has presented new challenges to governments in managing their economies and a growing sense of economic uncertainty among economic actors as they face strong international competition and the need for adjustment. All these factors are undermining the traditional separation between the domains of domestic and international policies. We illustrate some of these challenges by reviewing two key international agreements: the Agreement on Trade-Related Intellectual Property Rights

(TRIPS), and the Agreement on Technical Barriers to Trade (TBT).

1. Introduction

Globalization is a multi-faceted process that describes economic and social forces that have produced rapid growth in world trade, even faster integration of the world's financial markets, and the spread of international production networks. Sharp reductions in costs of transport and communications have been a driving force, abetted by important policy and institutional changes like the creation of a liberal multilateral trade regime and the relaxation of capital controls. Global integration was also quite advanced in the late 19th and early 20th century. The current trend is, however, different in the following respects: (i) trade now represents a larger share of the global economy than at its pre-Depression peak; (ii) capital mobility has reached unprecedented levels; (iii) the communication, information and transport technologies currently driving globalization are contributing to a major restructuring/decentralization of production structures; (iv) multinational corporations have achieved a truly global presence, and the number of countries with home-grown multinationals has increased significantly; (v) the current phase of globalization does not involve permanent shifts of labor between countries (though there is a great deal more temporary movement of skilled labor); and (vi) most importantly, globalization now involves many more - and an increasing number of - countries.

Technological advances are not only contributing to a major restructuring of production structure: they have also shortened the economic distance between nations. Technological innovations, especially in information and communication technology, have contributed to a decline in transaction costs for individual firms, allowing them to pursue world-wide sourcing strategies with the consequence of a widening in the range of enterprises for which global operations are commercially viable. Competition between global firms is increasingly being conducted in the area of new technologies and production processes. Moreover, new technologies, along with regulatory innovations, have made it possible to supply many infrastructure services on a competitive basis and have opened up possibilities for international trade in such services. At the same time, research and development costs and the economies of scale involved are fostering new strategic alliances between firms.

While the decades following World War II were characterized principally by closer integration among OECD countries, in the last two decades new players have entered onto the stage. A rapidly expanding group of developing countries and economies-in-transition have taken deliberate - and in many cases drastic - steps to open their economies wider to the outside world. They are liberalizing imports, promoting exports, encouraging foreign investment, and decontrolling foreign exchange regimes. Such development strategies have already propelled a number of these countries into the front ranks of trading nations and recipients of foreign investments.

Equally important, the increasing globalization of economic activity has intensified policy interaction in traditional areas as well as in new areas of multilateral economic co-operation. This has resulted in a deepening and broadening of the international economic agenda, and has thus influenced governments' approaches and priorities with respect to policy in at least two significant ways. First, a number of new policy areas that have either found their way onto the international agenda, or are under discussion, are not necessarily about trade *per se*, but rather are treated as 'trade-related' matters. This is most obvious in the case of intellectual property rights, labor standards and environmental issues. In these areas, an organic link may exist between the issues at hand and trade policy, but it may also be the case that the trade policy dimension is concerned primarily with the question of enforcement. In other words, the link between policies in such areas as those mentioned above and trade policy may reside fundamentally in the notion that the threat of denial of trade benefits offers an effective means of enforcing unrelated policy obligations. The practical implication of this tendency for bodies like the World Trade Organization is that subjects brought within the institution's purview will not necessarily relate to traditional areas of concern. This is but one reflection of how closer economic integration among nations triggers broad-based policy responses from governments.

More generally, governments have demonstrated increasing concern with a broad range of policy-related determinants of competitiveness. The globalization of economic activity has nurtured a growing interest in the numerous ways in which the conditions of market access may be influenced. Perhaps the area where this concern is most noticeable is in standard-setting and domestic regulation more generally. Sensitivity to the reality that regulations can be manipulated to tilt the conditions of competition in favor of a subset of economic actors, together with the realization that sharply divergent preferences in such matters as environmental quality and social policy are increasingly crucial determinants of competitive advantage, have increased pressures for harmonization in many policy areas. Such harmonization may be negotiated, or may come about through *de facto* competition among regulatory systems. Whichever approach dominates, the imperative felt by governments to ensure that their economic constituencies are not placed at a disadvantage through sharply different approaches to policy intervention can be a source of significant friction at the international level. Managing this friction is one of today's most pressing challenges for policy-makers.

Second, globalization and a growing attachment to regionalism seem to have coexisted in a manner that might seem contradictory at first sight. At the same time as barriers to integrated economic activity on a global scale appear to be disintegrating, governments' fascination seem to grow with intensified co-operation bounded by a localized or regional focus. If the phenomenon of growing interdependence is apparent not only in respect of relations with near neighbors, why limit the policy response to this subset of players? The risk of too narrow a policy focus is that the economic benefits of globalization may be compromised through regional integration arrangements that discriminate against outsiders. On the other hand, it is probable that a regional approach has been preferred more because of the greater ease of managing a complex set of relations among a limited number of like-minded countries than because governments have wished to discriminate. To the extent that this is the case, the risk is not great that the prominence of geographically-bound policy responses to international economic integration will frustrate natural tendencies towards globalization. Nevertheless, the danger that regionalism could become a splintering and destructive force cannot be ignored, and should remain uppermost in the minds of policy-makers.

Unsurprisingly, much of the policy reaction to globalization tends to crystallize around efforts at trade and investment liberalization. The proliferation of recent liberalization initiatives, and the tendency for negotiations to focus on an ever-broadening range of "behind-the-border/in your face" issues of domestic rule-making have given trade and investment liberalization negotiations an immediacy and proximity that were largely absent from earlier efforts at removing border impediments on manufactured goods alone.

2. Globalization Trends

2.1. Investment

Cross-border capital flows began to experience spectacular growth in the mid-1980s. The liberalization and deregulation of financial markets, privatization of state enterprises, and the advent of new information technologies, together with the emergence of new financial instruments, have combined to create a conducive environment for growing cross-border capital flows. For example, the value of cross-border assets held by banks more than tripled between 1973 and 1998; average daily turnovers in foreign exchange markets have grown from about $200 billion in the mid-1980s to more than $1.4 trillion today, equivalent to approximately 87 percent of all countries' foreign exchange reserves. Even after allowing for resale, daily foreign exchange transactions amount to well over $700 billion, more than 50 times the value of total worldwide trade in merchandise and services. In addition, cross-border transactions in bonds and equities in the major advanced OECD economies reached more than 100 percent of GDP in 1998, as compared to 10 percent just ten years ago.

Foreign direct investment has been catching up to international trade, having grown at nearly 17 percent per annum during the period 1981-1998, more than twice as fast as world-wide trade in goods and services and nearly five times faster than gross domestic product (Table 1, Panel A). Global outflows of FDI experienced more than a ten-fold rise - from $59 billion in 1981 to $617 billion in 1998.

A - World

Year	GDP	FDI	Trade
1981	17434	59	3902
1982	17533	42	3638
1983	17973	40	3584
1984	18846	50	3791
1985	19454	53	3838
1986	20108	82	4211
1987	21022	131	4975
1988	21967	152	5739
1989	22746	188	6546
1990	23322	192	7512
1991	25881	146	8522
1992	26331	158	9567
1993	26682	206	9270
1994	27471	231	10274
1995	28213	311	12104

1996	29199	347	12674
1997	30245	439	13035
1998	30705	617	12802
Average Growth (%) 1981-1998	3.3	16.7	6.9

B - Non-OECD Countries

Year	GDP	FDI	Trade
1981	2923	10	705
1982	2966	10	666
1983	3037	9	640
1984	3278	8	630
1985	3348	10	642
1986	3534	9	634
1987	3891	11	731
1988	4061	16	819
1989	4176	25	1196
1990	4260	21	1338
1991	4354	29	1294
1992	4428	40	1798
1993	4577	57	1679
1994	4755	74	1819
1995	4964	95	2116
1996	5148	114	2251
1997	5377	153	2389
1998	5392	160	2267
Average Growth (%) 1981-1998	3.4	21.1	7.9

Source: World Bank, *World Development Indicators*

Table1. Trends in GDP, FDI and Trade, 1981-1998Most dramatic has been the more than 16-fold increase between 1981 and 1998 in FDI flows to non-OECD countries, from $10 billion to $160 billion (Table 1, Panel B). FDI inflows have become the dominant form of resource flow to non-OECD countries, and their benefits go well beyond finance. These include technology transfer, the development of human capital and the promotion of foreign trade.

Private portfolio flows to non-OECD countries have also grown dramatically since 1981, as pension funds and other institutional investors in OECD countries have sought greater portfolio diversification through investment in overseas markets, including non-OECD markets. On the demand side, low international interest rates and improved creditworthiness have spurred new international bond issues as well as an upturn in foreign bank borrowing. In 1997, total borrowing on international markets reached $1.4 trillion, of which $105 billion or 8 percent were undertaken by non-OECD economies, up from less than 5 percent just a decade before. However, the financial crisis that beset some economies in 1997 has significantly reduced non-OECD countries' access to the international capital markets. Net long-term flows to non-OECD countries in 1998 declined to $261 billion, down from their record level of $328 billion in 1997 (Table 2).
The data reported in Table 2 describe the trend towards a more prominent role for private flows and the relative decline of official development finance. The share of

private flows in the total has doubled between 1990 and 1998 and it now accounts for almost 82 percent of total net flows to non-OECD economies. Since 1993, FDI-related net capital inflows to non-OECD economies are larger than official development finance and their share in total in 1998 stood at 65 percent. Debt financing contributed some 27 percent of net capital inflows while portfolio equity investments made up close to 6 percent. As such, portfolio equity flows constitute a standard form of investment into non-OECD economies.

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
Total Flows	97.0	118.0	145.8	209.9	208.8	244.8	295.9	327.8	261.3
Official Flows	56.9	62.6	54.0	53.3	45.5	53.4	32.2	39.1	47.9
Private Flows	40.1	55.4	91.8	156.6	163.3	191.4	263.7	288.7	213.4
of which:									
Private Debt Flows (*)	15.7	18.6	38.1	49.0	54.4	60.0	100.3	105.3	58.0
Portfolio Equity Flows	3.7	7.6	14.1	51.0	35.2	36.1	49.2	30.2	14.1
Foreign Direct Investment	20.7	29.2	39.6	56.6	73.7	95.3	114.2	153.2	141.3

(*) Private debt flows include: commercial banks loans, bonds and other private flows.

Source: OECD, Development Assistance Committee

Table 2. Net Resource Flows to Non-OECD Countries, 1990-1998 ($ billions)

Despite these overall positive developments, wide disparities have emerged across non-OECD countries. Table 3 shows that only 23 non-OECD countries were the main beneficiaries of FDI inflows. Among them, these countries attracted $127 billion in 1998, or 90% of the total FDI to non-OECD countries. In fact, two non-OECD countries (China and Brazil) were the destinations of more than half of FDI into the non-OECD area.

Country	FDI (million US $), 1998		Share in total non-OECD FDI, 1998	
China	43751		31.0	
Brazil	31913		22.6	
Thailand	6941		4.9	
Argentina	6150		4.4	
Malaysia	5000		3.5	
Chile	4638		3.3	
Venezuela	4435		3.1	
Colombia	3038		2.2	
Russia	2764		2.0	
India	2635		1.9	
Romania	2031		1.4	
Peru	1930		1.4	
Philippines	1713		1.2	
Panama	1206		0.9	
Vietnam	1200		0.8	
Kazakhstan	1158		0.8	
Egypt, Arab Rep.	1076		0.8	
Nigeria	1051		0.7	
Azerbaijan	1023		0.7	

Lithuania	926		0.7	
Croatia	873		0.6	
Bolivia	872		0.6	
Ecuador	831		0.6	
All above	127155		90	
Remaining non-OECD countries	14135		10	
All non-OECD countries	141290		100	

Source: World Bank, *World Development Indicators*

Table 3. Main Beneficiaries of FDI Inflows to Non-OECD Countries, 1998

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Biographical Sketch

Raed Safadi is the Head and the Principal Economist of Outreach and Analysis in the OECD Trade

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